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INDEMNIFICATION OF GOVERNMENT CONTRACTORS

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

S. 1254

A BILL TO PROVIDE FOR AN EQUITABLE REDUCTION OF LIABILITY OF CONTRACTORS WITH THE UNITED STATES IN CERTAIN CASES, TO PROVIDE A COMPREHENSIVE SYSTEM FOR INDEMNIFICATION BY THE UNITED STATES OF ITS CONTRACTORS FOR LIABILITY IN EXCESS OF REASONABLE AVAILABLE FINANCIAL PROTECTION, AND FOR OTHER PURPOSES

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INDEMNIFICATION OF GOVERNMENT CONTRACTORS—S. 1254

TUESDAY, JUNE 11, 1985

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 9:45 a.m., in room SD-106, Dirksen Senate Office Building, Hon. Strom Thurmond (chairman of the committee) presiding.

Also present: Senators Grassley and Specter.

Staff present: Michael Wootten, counsel; Neil Manne, counsel; Lisa Hovelson, legislative assistant; and Veronica Gonzales, legislative aide.

OPENING STATEMENT OF CHAIRMAN STROM THURMOND

The CHAIRMAN. The committee will come to order. We got tied up with the health fair this morning and got delayed a little bit.

Today, the Senate Judiciary Committee begins its consideration of S. 1254, the Contractor Indemnification Liability Act. In light of past actions by the Subcommittee on Administrative Practice and Procedure, and in an effort to accommodate Senator Grassley's desire to bring this matter to the attention of every member of this committee, I have agreed to hold S. 1254 at the full committee and holding this hearing today.

Senator Grassley and the Subcommittee on Administrative Practice and Procedure have been examining the third-party liability question as it applies to the Government and its contractors for some time. During the 98th Congress, in response to the 1977 Supreme Court holding in the *Stencel Aero Corp.* case and recurring questions of private party liability for extrahazardous governmental activities, the subcommittee reported S. 1839, legislation identical to the bill before the committee in this Congress.

The growth of the use of Government contractors in areas of high risk, such as military research and development, space exploration, medicine, and nuclear power, has increased the need to examine possible Government indemnification of its contractors where the contractor is engaging in necessary, but hazardous activities and where reasonable financial protection is not available elsewhere.

Equally important to this committee is the need to examine the question of fault allocation and the principles involved in the doctrine of sovereign immunity. Tort law, as we know it, has traditionally been based on fault.

This country has experienced a dramatic movement toward a "strict" or "no fault" standard of liability. Unfortunately, this development, when coupled with the misconception that the Federal Government and its contractors have infinitely "deep pockets," has led to larger judgments for little or no fault.

It is not difficult to understand why a reasonable contractor would be reluctant to undertake a vital Government program in an area frought with catastrophic risk or incalculable loss potential without adequate financial protection.

My distinguished colleague from Iowa, the chairman of the Subcommittee on Administrative Practice and Procedure, Mr. Grassley, should be commended for his work toward resolving this issue and for again focusing attention on the recent developments in tort law.

Before I call the first witness, I wish to place the text of S. 1254 in the record.

[Text of S. 1254 follows:]

By Mr. GRASSLEY:

S. 1254. A bill to provide for an equitable reduction of liability of contractors with the United States in certain cases, to provide a comprehensive system for indemnification by the United States of its contractors for liability in excess of reasonably available financial protection, and for other purposes; to the Committee on the Judiciary.

CONTRACTOR LIABILITY AND INDEMNIFICATION ACT

Mr. GRASSLEY. Mr. President, the legislation that I ask this Chamber to focus on today concerns the current law relating to contribution between the United States and its contractors. I introduced this bill in the last Congress after a great deal of study. I have, in my position as chairman of the Judiciary Subcommittee on Administrative Practice and Procedure, had four hearings on this topic. The bill that I introduce is a response to the concerns that have been raised at those hearings. Last year the bill was favorably reported from my subcommittee to the full Judiciary Committee, but time constraints prevented full committee consideration of the legislation.

Under provisions of the bill which we are examining today, a Government contractor may seek idemnification from the Federal Government for any damages or losses sustained as a result of suits brought solely against the contractor. The legislation also provides that the Government will include an indemnification provision in contracts where the risks are defined as unusually hazardous or nuclear in nature or giving rise to the possibility of liability against which the contractor cannot reasonably protect through private insurance or self-insurance.

As a means of providing some of the background as to the Government fault problem, I cite to you the 1977 Supreme Court case of Stencel Aero Engineering Corporation versus United States. Stencel, a Government contractor, sought to obtain indemnification from the Government for liability incurred as a result of a personal injury suit brought by a military officer who had been injured when the ejection system of his fighter aircraft malfunctioned. The Government had specified the design of the system, and Stencel contended that the defects in the specifications about which he had complained to the Government to no avail, had caused the injuries to occur. The Court nevertheless held that the subcontractor could not obtain indemnity from the Government for claims made against it by military personnel.

Another problem is the catastrophic losses that might be suffered by the contractor—even if the contractor has followed specifications issued by the Government. These risks are inherent in many essential Government projects such as military activity, medical research, use and disposal of hazardous substances, vaccination programs, satellite and missile launching and reentry, and air traffic control. Liability for supplying these types of services could easily exceed both the available insurance and the net worth of those contractors. This could spell financial disaster for the contractor and the victim unable to obtain compensation.

While there is existing authority under Public Law 85-804 to indemnify contractor, past testimony from the Office of the Under Secretary of Defense, through Mary Ann Gillece, indicated that the use of existing indemnification authority is very unusual. Indemnification is currently provided in less that one one-thousandth of 1 percent of military contract actions—that's 93 out of 12 million in 1982. As a result, I believe we will see more and more conscientious contractors increasingly deterred from participating in essential procurements involving catastrophic risk.

I hope that all of my Senate colleagues will join me in sponsoring this bill.

I ask that the bill as well as the accompanying section-by-section analysis be printed in its entirety.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

S. 1254

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Contractor Liability and Indemnification Act".

DECLARATION OF PURPOSE

SEC. 2. It is the purpose of this Act to establish fair and equitable apportionment of liability incurred by contractors with the United States by (1) providing for an equitable reduction of liability in cases in which acts or omissions of employees of the United States are wholly or partially the cause of a contractor's liability to a Government employee, and (2) providing a comprehensive system of complete indemnity for contrac-

tors against liability in excess of reasonably available financial protection.

DEFINITIONS

SEC. 3. As used in this Act—

(1) the term "contractor" means any person who has contracted with the United States to supply a product or service and such person's subcontractors and suppliers at any tier for such purpose;

(2) the term "person" means any individual, corporation (excluding a wholly owned corporation of the United States), company, foundation, association, organization, firm, partnership, society, charitable institution, or State or local unit of government;

(3) the term "claimant" means any person who asserts a claim which gives rise or may give rise to liability;

(4) the term "State" includes the District of Columbia and all territories or possessions of the United States;

(5) the terms "United States" and "contracting agency" means the Federal executive agencies and departments, the Federal military departments (including any unit or part of the National Guard of any State), independent establishments of the United States, and corporations primarily acting as instrumentalities or agencies of the United States;

(6) the term "liability" means the legally binding obligation to compensate for harm as provided for in final judgments of courts of law, settlements, or arbitration decisions;

(7) the term "harm" means (a) damage to or loss of use of property; (b) personal physical injury, illness, or death; (c) mental anguish or emotional distress resulting from an occurrence of personal physical injury, illness, or death; and/or (d) financial detriment, including loss of revenue or profits or other economic loss; and

(8) the term "fault" means acts or omissions that are in any measure negligent or wrongful with regard to the harm incurred by a claimant.

EQUITABLE REDUCTION OF LIABILITY

SEC. 4. (a) In any civil action brought by an employee of the United States or by the employee's legal representative, estate, spouse, dependent, survivor, or relative in any State court or in any district court of the United States alleging liability of any contractor for harm concerning which the employee or the employee's legal representative, estate, spouse, dependent, survivor, or relative is or has been entitled to receive worker compensation benefits from the United States, upon request of any party the court shall make findings of fact as to the proportion that the fault of the United States bears to the total fault of all persons and the United States in causing harm which gives rise to the claim of liability. The court shall reduce any judgment for liability rendered against the contractor by the proportion of fault of the United States found by the court. The amount the United States is entitled by law to obtain through right of subrogation or subrogation lien arising from worker compensation payments for harm concerning which contractors are or may be held liable shall be reduced by the proportion of fault of the United States in causing the harm.

(b) A contractor against whom a civil action alleging liability is brought shall give written notice to the Attorney General of the United States, within ninety days of the filing of the civil action, if the contractor intends to seek an equitable reduction of liability pursuant to subsection (a) of this section. Except as otherwise directed, the contractor shall promptly furnish to the Attorney General a copy of all pertinent papers received or filed with respect to such civil action. The United States shall have the right, for a period of ninety days following receipt of any such notice, to intervene as a party in any such civil action. Any such civil action commenced in a State court in which the United States has intervened may be removed, at the election of the United States, along with any related pending action by a claimant, without bond at any time before a trial on the merits, to the district court of the United States for the district and division embracing the place wherein the State court action is pending. Should a United States district court determine, pursuant to an evidentiary hearing on a motion to remand held before the trial on the merits, that there is no substantial evidence of any fault on the part of the United States in causing harm to the employee of the Government, such civil action shall be remanded to the State court.

(c) In determining the proportion of fault of the United States pursuant to subsection (a) of this section, the court shall consider such evidence of fault as may be introduced by the parties in accordance with the rules of evidence and shall consider, among other relevant factors, the following:

(1) the nature of contract provisions or specifications associated with acts or omissions contributing to the harm, the relative responsibility of the United States and the contractor for the existence of such provisions or specifications, and the relative degree of knowledge, skill, and expertise of the contractor and the United States as to potential harm which might be associated with contract performance or nonperformance under such provisions or specifications;

(2) the existence of officially promulgated standards of the United States which are associated with acts or omissions contributing to the harm;

(3) the degree to which products or services furnished by the United States to the contractor under the contract are associated with acts or omissions contributing to the harm, and the relative degree of knowledge, skill, and expertise of the contractor and the United States as to potential harm which might be associated with use of such products and services;

(4) acts or omissions in performance of the contract by employees of the contractor or the United States which contribute to the harm and the relative responsibility of the contractor and the United States for the occurrence of such acts or omissions; and

(5) the degree of control or care exercised by the United States in the use, application, and maintenance of products or services after delivery by the contractor.

(d) The provisions of this section supersede any State law regarding matters covered by this section.

INDEMNIFICATION OF CONTRACTORS

SEC. 5. (a) The United States shall include in any contract hereafter made, and may include by amendment or modification in any contract heretofore made, a provision that the United States will hold harmless and indemnify the contractor against any of the claims or losses set forth in subsection (b), whether resulting from the negligence or wrongful act or omission of the contractor or otherwise, except as provided in subsection (b)(2): Provided, That such provision shall apply only to claims for losses arising out of or resulting from risks that the contract defines as (1) unusually hazardous or nuclear in nature or (2) giving rise to the possibility of liability against which the contractor cannot reasonably protect through private insurance or self insurance: And provided further, That no such provision shall be included in any contract for procurement of goods or services which are sold by the contractor to nongovernmental purchasers for uses or applications identical in nature, magnitude, and scope to the uses or applications made or to be made of the goods and services by the United States. A determination of whether the conditions contained in the preceding sentence have been met shall be made in advance by the head of the contracting agency or his designee (who shall be an official at a level not below that of an assistant to the head of the contracting agency). A contractual provision for indemnification may require each contractor as indemnified to provide and maintain financial protection of such type and in such amounts as is determined by the head of the contracting agency or his designee to be appropriate under the circumstances. In determining whether conditions for the use of an indemnification provision have been met and in determining the amount of financial protection to be provided and maintained by the indemnified contractor, the appropriate official shall take into account such factors as the availability, cost, and terms of private insurance, self insurance, other proof of financial responsibility, and worker compensation insurance. The determination of the head of the contracting agency or his designee as to whether conditions for use of a contractual provision for indemnification have been met shall be final for purposes of the judicial review specified in subsection (c).

(b)(1) Subsection (a) of this section shall apply to claims, including reasonable expenses of litigation and settlement, or losses not compensated by insurance or otherwise, of the following types:

(A) claims by third persons, including of the contractor, for death, personal injury, or loss of, damage to, or loss or use of properties;

(B) loss of, damage to, or loss of use of property of the contractor;

(C) loss of, damage to, or loss of use of property of the Government; and

(D) claims arising (i) from indemnification agreements between the contractor and a subcontractor or subcontractors, or (ii) from such arrangements and further indemnification arrangements between subcontractors at any tier, provided that all such arrangements were entered into pursuant to procedures prescribed or approved by the contracting agency.

(2) Indemnification and hold harmless agreements entered into pursuant to this section, whether between the United States and a contractor, or between a contractor and a subcontractor, or between two subcontractors, shall not cover claims or losses caused by the willful misconduct or lack of good faith on the part of any of the contractor's or subcontractor's directors or officers or principal officials. For purposes of this subsection, the term "principal officials" means any of the contractor's managers, superintendents, or other equivalent representatives who have supervision or direction of (A) all or substantially all of the contractor's business, (B) all or substantially all of the contractor's operations at any one plant or separate location to which a contract is being performed, or (C) a separate and complete major industrial operation in connection with the performance of a contract.

(3) The United States may discharge its obligation under the contractual provision authorized by subsection (a) of this section by making payments directly to contractors or subcontractors or to third persons to whom a contractor or subcontractor may be liable.

(c) A contractual provision under subsection (a) of this section which provides for indemnification must also provide for—

(1) notice to the United States of any claim or action against, or any loss by, the contractor or subcontractor covered by such contractual provision; and

(2) control or assistance by the United States, at its election, in the settlement or defense of any such claim or action.

(d) Upon application by a contractor or subcontractor, each contracting agency shall determine, or upon its own initiative, each contracting agency may determine, after opportunity for a hearing (in accordance with section 553 of title 5, United States Code), whether any past, present, or future contract or class or category of contracts involves risks of the type set forth in subsection (a) of this section.

(e) Any contractor or subcontractor aggrieved by any decision or determination of the contracting agency pursuant to subsection (a) or subsection (d) of this section may, within sixty days of such decision or determination, petition the United States Court of Appeals for the Federal Circuit to review such decision or determination. The decision or determination of the contracting agency with respect to questions of fact, if supported by substantial evidence on the record considered as a whole, shall be conclusive.

(f) The provisions of sections 1431-1436, title 50, United States Code, shall not apply to indemnification of contractors as provided in this section. The provisions of section 2354, title 10, United States Code, are hereby repealed. Section 241(a)(7), title 42, United States Code, is hereby amended to delete the reference to section 2354, title 10, United States Code. The provisions of this section shall not apply to any risks against which indemnification may be obtained pursuant to section 1218, title 42, United States Code.

(g)(1) Notwithstanding the provisions of section 665, title 31, or section 11, title 41, United States Code, contracting agencies are hereby authorized to make indemnification payments pursuant to any indemnification provisions of their contracts from (A) funds obligated for the performance of the contract from which the contractor's liability arises; (B) funds currently available for contracts of the nature of the contract from which the contractor's liability arises, and not otherwise obligated; (C) funds specifically appropriated for such payments; and/or (D) funds appropriated pursuant to section 726(a), title 31, United States Code.

(2) The Supplemental Appropriations Act, section 724(a), title 31, United States Code, is hereby amended by adding the words and section 5 of the Contractor Liability and Indemnification Act" after the words "or 2677 of title 28".

EFFECTIVE DATE

Sec. 6. This Act shall be effective as of the date it is signed into law by the President.

SECTION-BY-SECTION ANALYSIS OF S. 1839

PURPOSE

The purpose of this proposed Act is to provide a comprehensive system for indemnification by the United States against liability in excess of reasonably available financial protection and to provide for a reduction in liability in cases in which the negligence of United States employees contributes to that liability.

SECTION-BY-SECTION ANALYSIS

Section 1 states that the Act may be cited as the "Contractor Liability and Indemnification Act."

PURPOSE

Section 2. The stated purpose of the Act is to provide a reduction of liability for government contractors in cases where the acts or omissions of United States employees have contributed to that liability and to provide a comprehensive system of indemnity for contractors against liability in excess of reasonably available financial protection.

DEFINITIONS

Section 3. This section defines terms used in the Act. Several of the terms are defined in the customary manner. "Contractor" includes state and local units of government as well as the usual forms of organizations excluding wholly-owned by the United States corporations. "Claimant" means any person who asserts a claim now or in the future which may give rise to liability. "State" includes the District of Columbia as well as the territories or possessions of the United States. "Liability" means the legally binding obligation to compensate for harm as provided for in final judgments of courts of law, settlements, or arbitration decisions.

The definitions of other terms are more closely tied to their usage in the Act. For example, the terms "United States" and "contracting agencies" include those corporations acting as instrumentalities or agencies of the United States and state National Guard units, as well as federal executive agencies and departments and federal military departments. The term "harm" includes damages for injury to property or person, and emotional distress resulting from an occurrence of personal injury or default. Thus, damages for wrongful death would be available under the Act. The term "harm" as used in the Act also means financial detriment, including loss of revenue or profits or other economic loss. Ordinarily, damages in common law tort actions such as negligence or strict liability are not available for claims of purely economic loss. See e.g., James, "Limitations on Liability for Economic Loss caused by Negligence: A Pragmatic Appraisal", 20 Vanderbilt Law Review 43 (1972).

The theories of negligence and strict liability were possibly not intended to protect citizens from economic losses unattended by physical injury to persons or property. See also, *Just's Inc. v. Arrington Construction Co.*, 99 Idaho 462 at 470, 583 P. 2d 997, at 1005 (1978): "the common underlying pragmatic consideration is that a contrary rule, which would allow compensation for losses of economic advantage caused by the defendant's negligence, would impose too heavy and unpredictable a burden on the defendant's conduct."

The last term defined by the Act is "fault", which means acts or omissions that are in any measure negligent or wrongful with respect to the harm incurred by a claimant.

EQUITABLE REDUCTION OF LIABILITY

Section 4. Subsection (a) of section 4 permits a court, upon the request of any party, to make a finding of fact regarding the proportion of fault of the United States in regard to a claim of liability against a government contractor where the claimant or the claimant's representative (including estate, dependents, survivors, spouse, or legal representative) has been entitled to receive worker compensation benefits from the United States. This subsection instructs the court to reduce any judgement for liability rendered against the contractor by the proportion of fault of the United States found by the district court. The right of subrogation to which the United States is ordinarily entitled when contractors are found liable shall be limited by the proportion of fault of the United States in causing the harm giving rise to the liability.

Subsection (b) of section 4 directs a defendant contractor to give written notice to the Attorney General of the United States within 90 days of the filing of the suit against the contractor if equitable reduction pursuant to subsection (a) is sought. The contractor shall furnish the Attorney General copies of all papers pertinent to the civil action filed against the contractor.

The remaining 6 portions of subsection (b) govern intervention and removal by the United States. The Government has the right to intervene in any action for which it receives notice under this subsection. The Government may remove the action in question as well as any related pending action by a claimant to a United States District Court. If the district court, pursuant to an evidentiary hearing on a motion to remand, finds no substantial evidence of any fault on the part of the United States, the civil action shall be remanded to the state court. The hearing on the motion to remand would take place before the trial on the merits. Thus, the liability of the United States, the primary issue governed by this Act, may be determined prior to trial on the merits and decided by a judge. In some instances, the only issue decided by the district court could be that of the Government's liability; the initial claim against the contractor would still be decided by the state court.

Subsection (c) establishes the factors for the court to consider, in accordance with the rules of evidence, in determining the proportion of fault of the United States. These factors include the following:

(1) the nature of contract provisions or specifications associated with whatever incidents gave rise to the alleged harm, the relative responsibility of the United States and the contractor for the existence of such provisions or specifications, and the relative ability of the United States and the contractor to discern possible harm resulting from performance or non-performance under such contract provisions or specifications;

(2) the existence of officially promulgated standards of the United States which are associated with acts or omissions contributing to the harm;

(3) the degree to which products or services supplied by the United States to the contractor contributes to the incidents causing harm, and the relative ability of the United States and the contractor to discern which of such products or services might contribute to potential harm; and

(4) the acts or omissions in performance of the contract by employees of both the United States and the contractor which contribute to the harm and the relative responsibility of the contractor and the United States for the occurrence of such acts or omissions; and

(5) the degree of continuing control or supervision exercised by the United States in the use, application and maintenance of products and services delivered to the contractor. Subsection (c) states that the provisions of section 4 shall supersede any state law regarding matters covered by the section. The authority for this subsection is Article VI of the United States Constitution which states in clause 2 that "[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land. . . ." This clause, known as the Supremacy Clause, gives Congress the authority to legislate and thereby impose legal obligations beyond what exists on the state level when a particular national interest is served.

INDEMNIFICATION OF CONTRACTORS

Section 5 (a). Section 5, subsection (a) directs the United States to prospectively include in contracts indemnification clauses holding contractors harmless against claims or losses set forth in subsection (a), regard-

less of the possible fault of the contractor, provided that: "Such provision shall apply only to claims for losses arising out of or resulting from risks that the contract defines as (1) unusually hazardous or nuclear in nature or (2) giving rise to the possibility of liability against which the contractor cannot reasonably protect through private insurance or self-insurance: provided, further, that no such provision shall be included in any contract for procurement of goods or services which are sold by the contractor to nongovernmental purchasers for uses or applications identical in nature, magnitude, and scope to the uses or applications made or to be made of the goods and services by the United States."

A designated official at a contracting agency shall determine whether the requirements of the above are met. In addition, the designated official shall determine the type and amount of financial protection in the form of insurance which is appropriate for the circumstances. The official shall take into account such factors as the availability, cost, and terms of private insurance, self-insurance, other proof of financial responsibility, and worker compensation insurance. Determination by any official under this subsection shall be final for purposes of the judicial review specified in subsection (c).

Subsection (b)(1) states that the indemnification provisions of subsection (a) shall apply to claims, including reasonable litigation expenses and uncompensated losses of the following types:

(A) Third party claims for injury to persons or property;

(B) Loss of use of or damage to the contractor's property; and

(C) Loss of use of or damage to Government property; and

(D) Claims arising from indemnification agreements among contractors and subcontractors.

Subsection (b)(2) excepts from coverage of indemnification agreements entered into pursuant to this section claims or losses caused by the willful misconduct or lack of good faith on the part of any of the contractor's or subcontractor's directors, officers, or principal officials. "Principal officials" is defined as any of the contractor's managers, superintendents, or other representatives who have supervision over all or substantially all of (1) the contractor's business, (2) the operations of any plant or location where a contract is performed, or (3) a separate, major industrial operation in connection with the performance of a contract.

Subsection (b)(3) would permit the United States to discharge any indemnification obligations directly to the parties, including contractors, subcontractors, and third persons to whom the contractors or subcontractors may be liable.

Subsection (c) requires that in any indemnification provision the contract shall also provide for notice to the United States of any claim or loss covered by such provision and control or assistance by the United States in the settlement or defense of any such claim.

Subsection (d) provides that each contracting agency may determine, after opportunity for a hearing in accordance with 5 U.S.C. S. 553, whether any past, present, or future contracts involve the risks of the type set forth in subsection (a) of this section. Thus, the possibility of the contractor obtaining indemnification shall be retroactive under this subsection.

Subsection (e) provides for appellate judicial review of any decision or determination under subsection (a) or (d). However, the decision of the contracting agency, if supported by substantial evidence on the record, shall be conclusive. Thus, the burden of proof in any appeal of a contracting agency's decision will be on the opponent of that decision.

Subsections (f) and (g) are technical in nature, referring primarily to affected areas of the United States Code. Under subsection (f), 50 U.S.C. SS 1431-1436, governing the authority of the heads of named agencies to enter into contracts in connection with national defense functions, shall not apply to indemnification of contractors as provided by the bill. In addition, 10 U.S.C. S. 2354, which currently provides indemnification for contractors in connection with certain ultrahazardous activities, would be repealed. Proposed S. 1839 is broader in scope than 10 U.S.C. S. 2354, since the bill does not solely limit the availability of indemnification by the nature of the activity to be performed under the contract, but provides indemnification for any activity for which the contractor has no or insufficient financial protection. 42 U.S.C. S. 241(a)(7) would be amended to delete the reference to section 2354 of title 10. The provisions of this bill would not affect the indemnification and limitation of liability provided for in 10 U.S.C. S 2210, which applies to the Nuclear Regulatory Commission.

Subsection (g)(1) would authorize the contracting agencies to make indemnification provisions from (A) funds obligated for the particular contract; (B) funds currently available for contracts of the same type as the one giving rise to the liability in question; (C) funds specifically appropriated for such payments; or (D) funds appropriated pursuant to section 31 U.S.C. S 724 (a), which authorizes appropriations for payments of judgments and compromise settlements against the United States. The authorization pursuant to this subsection would permit payment notwithstanding the provisions of 31 U.S.C. S 665, which prohibits expenditures of funds in excess of appropriations, and 42 U.S.C. S 11, which prohibits the making of contracts unauthorized by law.

Finally, under subsection (g)(2), 31 U.S.C. S 724(a), would be amended by adding the words "and section 5 of the Contractor Liability and Indemnification Act" after the words "or 2670 of title 28."

In sum, S. 1839, being prospective in nature, would not be subject to possible constitutional challenges of retroactive application. The purpose of S. 1839 is to waive sovereign immunity for those negligent actions to which the United States contributed, but for which the United States is not now liable under *Stencil Aero Engineering* v. *United States*, 431 U.S. 666 (1977). The effect of S. 1839 would be to expand the protection currently available to contractors when they engage in the Government's business. Although the form this protection would take depends upon the particular contract between the U.S. and its supplier, there would be concomitant changes in the current law. Such changes are desirable, given the substantial risks taken by those contractors willing to do defense and nuclear-related work.●

The CHAIRMAN. The committee has a distinguished group of witnesses appearing today, including Congressman Tom Kindness and Congressman Ed Feighan of the House Judiciary Committee. I would like to welcome all of our witnesses and thank them for their testimony. It is nice to have you before us.

I have had the pleasure of working with Congressman Kindness on so many matters and he has always been a very dedicated, capable Congressman and we are very honored to have him before the committee.

I believe you are the first witness, are you not, Congressman Kindness?

Mr. KINDNESS. Mr. Chairman, thank you very much. I would be happy to serve in that capacity as the first witness.

The CHAIRMAN. You may proceed.

STATEMENT OF A PANEL CONSISTING OF HON. THOMAS N. KINDNESS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO; AND HON. EDWARD F. FEIGHAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. KINDNESS. Thank you, Mr. Chairman. It is a pleasure for me to appear today with my friend and colleague, Ed Feighan, to discuss an issue in which he and I have long been interested—protection of the public interest with regard to government contractor liability and indemnification.

The CHAIRMAN. Excuse me just a minute. Do you want to make an opening statement?

Senator GRASSLEY. Why do you not let him go ahead and make his statement?

The CHAIRMAN. You go ahead and make your statement and then Senator Grassley and Senator Specter will make their statements. You may proceed.

Senator GRASSLEY. If Senator Specter wants to make his opening statement——

The CHAIRMAN. Would you like to give your opening statement now, Senator?

Senator SPECTER. No, no. I would be glad to wait.

The CHAIRMAN. I did not realize you were here. Excuse me.

Senator SPECTER. I just did not want Senator Grassley to defer for me.

Senator GRASSLEY. Go ahead.

The CHAIRMAN. All right, you may proceed.

Mr. KINDNESS. Mr. Chairman, I am perfectly willing to toss a coin.

In the 98th Congress, former Congressman Sam Hall and I sponsored a bill known as H.R. 5883, the Contractor Liability and Indemnification Act. That bill was approved without dissent in the Administrative Law and Governmental Relations Subcommittee in the House, but the full House Judiciary Committee was unable to consider the legislation before the Congress adjourned.

This year, 18 members from both sides of the aisle joined with Congressman Feighan and me in sponsoring H.R. 1623, which we have entitled the "Fair Allocation of Government Fault Act,"

which is virtually identical to the bill which died at the end of the last Congress.

I expect that the Administrative Law Subcommittee will consider the bill soon, as Representative Dan Glickman of Kansas will apparently, while we meet here this morning, be confirmed as the chairman of the Administrative Law Subcommittee of the House Judiciary Committee, replacing Sam Hall. So we would hope that on the other side of the Hill, we may be proceeding promptly with this subject.

For the purposes of my testimony, Mr. Chairman, I am going to limit my discussion today to H.R. 1623, in the hope that our experience with regard to that bill on the other side of the Hill will be of value to you in your consideration of the issue.

H.R. 1623 deals with two important issues affecting Government contractors—first, the indemnification of contractors in the event of a catastrophic accident which exceeds the level of commercially available insurance; and, second, the liability of Government contractors when Federal employees are injured by a product and the Government and/or its employees are partly or totally at fault.

The concept of indemnifying Government contractors engaged in work for the Government that is on the leading edge of technology is not new. In 1958, the Congress passed Public Law 98-804, which, in part, authorized the indemnification of contractors when required to facilitate the national defense.

Executive Order 10789, which implemented that law, gives the Department of Defense the authority to indemnify contractors for risks that are unusually hazardous or nuclear in nature.

Unfortunately, Public Law 85-804 and the Executive order have been only limited in use over the last 27 years. Few, if any, contractors are ever covered by its provisions, since the awarding of indemnification is optional on the part of the contracting agency and few, if any, agencies are willing to admit that a contract is unusually hazardous or nuclear.

On the average, the Department of Defense has chosen to provide indemnification on fewer than 100 out of the millions of contracts that it awards annually. However, contractors produce many more items for various Government agencies which are on the frontiers of technology and contain often unforeseeable and potentially devastating liabilities.

Clearly, the Defense Department's lack of enthusiasm in utilizing the indemnification provisions of Public Law 85-804 causes potential problems for both the contracting community and for the general public.

Realistically, only a finite amount of insurance exists in the commercial marketplace for contractors to purchase. Some estimate the maximum insurance coverage available for any one product at about $500 million, and the figure has been shrinking over the past year as the insurance marketplace has taken into account major underwriting losses on space, environmental and product liability insurance.

As a result, many, if not most, contractors are woefully underinsured in the event of a catastrophic incident; thus comes in the public interest. The tragedy that recently occurred in Bhopal, India, in a somewhat parallel fashion indicates how unexpectedly

an accident of this type can occur, and even more importantly the possible costs of compensating the victims of such an accident.

Those costs could exceed a contractor's available insurance and his net worth in short order. The result would be a bankrupt company, thousands of employees out of work, and many injured parties left uncompensated.

As a matter of public policy, I believe that the Congress has an obligation to ensure that our system of government contract and tort law do not become vehicles through which injured parties are reduced to the status of judgment creditors presiding over the liquidation of otherwise profitable and necessary companies. This would visit the greatest harm upon the injured parties and the innocent employees of such a firm.

I believe that we need a system for dealing in advance with just such an eventuality. H.R. 1623 would indemnify all Government contractors, not just those of the Defense Department, for liability that either exceeds a level of commercial insurance agreed upon in advance by the contractor and the contracting agency, or an amount that would be considered reasonable at the time the liability occurred.

Therefore, the contractor would be required, as he must do now, to go into the commercial insurance marketplace and purchase as much insurance as is reasonably possible given the product and the element of risk.

In the event of a catastrophic accident, the Government would serve as a second-tier insurer, a backstop, compensating the victims only after all of the commercial insurance was exhausted.

This indemnification would provide both contractors and injured persons with an established mechanism and procedure for compensating the victims of a large-scale accident, eliminating much of the delay, uncertainty and protracted litigation that now beset both injured persons and contractors in this type of case.

In order to protect the Government from unnecessary or unworthy indemnification claims, liability created by the gross negligence, the misconduct or lack of good faith of a contractor and its directors, officers or managing officials would not be indemnified. Such acts would not be subject to indemnification.

The purpose of this legislation is not to relieve Government contractors of their responsibility to deliver quality goods and services. Rather, it would help to improve the competitive picture in the procurement of Government goods and services by lessening the potential liabilities of contractors and providing an incentive for other contractors to enter into certain hazardous endeavors that they might not otherwise want to undertake.

And we are all well aware of how important it is to provide incentives that would increase competition in contracting, and thereby lower costs and improve product quality.

Therefore, I feel that this sort of legislative approach would fulfill two important needs—to protect the public in the event of a catastrophic accident and to promote increased competition in Government contracting. Thus, the taxpayers' interests would best be served.

The second major aspect of H.R. 1623 arises within the context of simple equity—the apportionment of liability in cases where a Fed-

eral employee is injured by a product and the Government or its employees are either partly or totally at fault in the accident.

As a result of the 1977 Supreme Court ruling in the *Stencel* v. *United States* case mentioned by the chairman, Government contractors sued by military personnel for product-related injuries cannot bring a third-party suit against the Government for those damages, regardless of whether the Government was partly or totally at fault in the accident.

As a result of this ruling, contractors are now liable for millions of dollars in damages caused by events over which they had little or no control. This situation is clearly unfair and needs to be rectified.

The Administrative Law and Governmental Affairs Subcommittee of the House Judiciary Committee held hearings on this issue in the last Congress, reviewed the problem, and as a result of this careful analysis decided that a system of equitable reduction was the fairest way to deal with this problem.

Under the equitable reduction provision of the House bill mentioned, a plaintiff's award from the contractor would be reduced by the percent of the Government's fault. The amount of Federal worker's compensation already received by the injured Government employee that then must be repaid to the Government by right of subrogation is likewise reduced by the percent of Government fault.

Therefore, while the plaintiff would see a reduction in the amount of his or her court award, depending on the degree of Government fault, the employee would be able to keep a greater percentage of the FECA award rather than giving it back to the Government through the Government's subrogation lien.

Other alternatives, such as overturning the *Stencel* decision and permitting contractors to file contribution claims against the Government in these cases or allowing Federal employees to sue the Government, are not realistic, given the present state of the Federal deficit and the condition, perhaps, of public policy as determined by the Congress at this point in time.

Federal employees injured on the job already receive worker's compensation and the Government can ill afford at this time to break down the worker's compensation bar against employer suits to pay a second form of compensation.

Indeed, while equitable reduction will not call for any additional Government expenditures, there will be a minor loss of revenue through the reduction of the Government's subrogation lien recoveries.

Under equitable reduction, contractors are liable for the harm that they cause. If a contractor is 100 percent at fault in an accident, it must pay full damages to the injured party, as determined in the lawsuit. If it is not at fault, it pays nothing. This is fair and reasonable and retains the incentive for contractors to produce safe and effective products.

Mr. Chairman, I am well aware that this is not the most propitious moment in history to promote legislation that would seem to benefit Government contractors. However, I strongly believe that this legislation would, first of all, protect the general public; second, improve the competitive climate in the procurement proc-

ess; and, third, reduce the excuse for Government contractors to build into their bids any larger contingency factors than would be required under this legislation.

I urge all of the members of the committee to consider this issue carefully, realizing its complexity, and I hope that the committee will report out a bill that will allow us to bring this concept into the law of the United States.

Mr. Chairman, members of the committee, I sincerely appreciate the opportunity to appear here this morning and to discuss the issue, and would be open for questions at the appropriate time.

The CHAIRMAN. What is the main opposition to this bill? The Justice Department, I believe, is opposed to certain portions of it, anyway.

Mr. KINDNESS. Mr. Chairman, I understand that following a great number of discussions over a period of time now, the position of the Department of Justice is a bit different than it has been in the past and there is an openness to the discussion of the issue with possibilities of some kind of modification of this approach by way of capping liability or what have you.

I am, of course, looking forward to the testimony to be presented in behalf of the Department this morning to determine more proximately what their position is at this point. I am very happy that the door is a little more open.

The CHAIRMAN. I was thinking after this hearing—not today, some other day—it may be possible that you and Senator Grassley and the Justice Department and maybe Senator Specter would get together and discuss it and see how far apart you are.

This is a matter that we ought to be able to get together on in some way. In other words, there really should not be too much division if we all sit down on both sides and see if we can work this thing out.

I am going to turn the hearing over now to the able Senator from Iowa, Senator Grassley. I have another appointment. Senator Grassley, if you will take the chair and carry on from there, thank you very much.

Again, it is a pleasure to have you gentlemen with us. Incidentally, Congressman Feighan, years ago I served here in Congress with a Congressman Feighan from Ohio and he was a good friend of mine. Was he your father?

Mr. FEIGHAN. No; he was my uncle, Senator—he is my uncle; I will have to amend that so that I do not give the wrong impression. He is in very good health and still living in Washington.

The CHAIRMAN. I think he was from Cleveland, was he not?

Mr. FEIGHAN. He was from Cleveland, although I do not represent any of the district that he represented, and he is, as I say, in fine health. He had served 30 years in the House.

The CHAIRMAN. He and his wife were on a trip overseas with my wife and me at that time and he was a delightful gentleman and a fine man.

Mr. FEIGHAN. I appreciate your asking, Mr. Chairman.

The CHAIRMAN. I hope you will be as sound and conservative as he was.

Mr. FEIGHAN. Thank you. I hope so. [Laughter.]

The CHAIRMAN. Thank you very much; glad to see you.

Mr. FEIGHAN. Thank you.

The CHAIRMAN. Tom, glad to see you again.

Mr. KINDNESS. Thank you, Mr. Chairman.

Senator GRASSLEY. Before the chairman goes, I want to thank him for holding this hearing at the full committee level so that we would be able to bring it to the attention initially of all of the members of the committee because last year hearings were held three times in the subcommittee. So, thank you very much for your indulgence.

The CHAIRMAN. Thank you.

Senator GRASSLEY [presiding]. Before I give my opening statement, I am going to go to the Congressman from Ohio and then I will have questions for both of you, and then I will give my rationale for the legislation prior to the calling of the people from Justice.

Would you proceed, colleague?

STATEMENT OF REPRESENTATIVE EDWARD F. FEIGHAN

Mr. FEIGHAN. Thank you, Mr. Chairman, and I am very grateful for the opportunity to testify before the committee this morning, and particularly to be here with my colleague from Ohio and from the House Judiciary Committee, Congressman Kindness.

I think he has done a very capable and a very effective job of outlining the importance of the Fair Allocation of Government Fault Act. Mr. Kindness has been working on this issue certainly for the few years that I have been in the Congress, and I know he has been working on it prior to that.

I think it is precisely because of his hard work and that of Senator Grassley that the Congress has been able to develop a bipartisan solution to the twin problems of product liability and catastrophic liability indemnification for Government contractors.

I would like, if I could, to focus—really, to limit my comments this morning to the need for a uniform system of Government indemnification of contractors for catastrophic liability.

In providing goods and services for many Government programs, contractors are exposed to a risk of liability which exceeds available insurance and which could cause financial disaster not only for the contractor, but also for injured persons unable to obtain compensation from that contractor.

Although the Government possesses some authority to indemnify contractors for excessive liability, that authority is far from comprehensive and has been used, as Congressman Kindness has already pointed out, very sparingly. As a result, I think many conscientious contractors have been deterred from participating in some otherwise risky Government projects.

For more than 25 years, experts from across the country have recognized the need to provide Government contractors with indemnification, and thus spread the risk of catastrophe more equally between the Government and the contractor.

Congress, in order to obtain a better understanding of the process, authorized the Commission on Government Procurement. In 1972, that Commission called for enactment of a comprehensive indemnification statute. Unfortunately for the Government as well

as the contractors, that recommendation has still not been implemented.

To implement that recommendation, Congressman Kindness has introduced House Resolution 1623. Section 4 of that legislation requires that in every contract made on or after the date of enactment, the United States shall hold harmless and indemnify the contractor against any catastrophic liability.

Indemnification would not apply if the catastrophe involved goods or services which are also sold by that contractor to nongovernmental purchasers or nongovernmental uses or applications. Further, no liability would arise on the part of the Government if the liability was caused by the contractor's lack of good faith, gross negligence or willful misconduct.

Finally, the contractor could be required by the contracting agency to secure and maintain specified amounts of commercial insurance or qualified self-insurance. In the absence of such an agreement, the contractor would be required to secure and maintain as much insurance as is reasonable at the time the liability is incurred.

This year's House bill is virtually identical, I understand, in most respects to the bill that was offered by Senator Grassley in the last Congress. I would like to urge my colleagues on the committee to give consideration to one very significant change in that legislation as was considered last year.

The legislation from the last session required a contract-by-contract evaluation of potential hazards before an indemnification clause could be added. Thus, the contracting agency and contractor would often be required to gaze into a clouded crystal ball to discover these potential hazards before an indemnification clause could be added.

I think this is not unlike the present contracting system where, on a more limited basis, contracting agencies are called upon to make the same kinds of judgments. Last year, testimony before the Subcommittee on Administrative Law in the House indicated that when faced with the choice of whether or not to grant indemnification, the bureaucracy inevitably tended and chose not to do so.

Thus, I fear that if that Senate version were adopted, we would have provided a remedy that perhaps would never be used. Therefore, I would recommend and urge the adoption of the House proposal of automatic indemnification provisions in those contracts.

In summary, companies that want to participate in Government procurement today are frequently asked to act imprudently. They must bear the entire risk of catastrophic liability in the event that something seriously goes wrong.

Ultimately, this policy, I think, as Congressman Kindness has very eloquently stated, strongly discourages private sector competition for Government contracts, which ultimately that the Government must pay more for the goods and services that it finally obtains.

I would urge my Senate colleagues to act as they have thus far on this issue in a bipartisan way to ensure rapid passage of some form of the proposals of the Fairer Allocation of Governmental Fault Act.

Thank you very much, Mr. Chairman.

Senator GRASSLEY. I want to thank both of my colleagues from the other body for their expert testimony in this area, and I have just a few questions—a couple directed to Congressman Kindness and a couple directed to the other Congressman from Ohio.

First of all, Congressman Kindness, could you explain in a little greater detail how the system of equitable reduction in your bill operates?

Mr. KINDNESS. Yes, Mr. Chairman. I think that it would probably be best to call upon the analogy of the system of apportionment of fault or liability that has been developed in the tort law of the various states. A majority of the States now, I believe, provide in tort cases, either by statutory provisions or development of their case law, for the comparative fault of parties defendant, where there is more than one defendant, to be apportioned, and the ultimate damages that are found to be payable would then be apportioned among the parties defendant according to that finding which is made in a jury case by a jury on a separate determination on that issue, in most cases, realizing the imperfection of all determinations of anything like that where you take facts that are presented in court and then try to apply a percentage of fault to them, but still it is the closest that our combined judicial systems have come up with to a good determination system.

That percentage, then, would apply in this way: Let us say it is a 50-50 split; the Government is found to be 50 percent at fault and the Government contractor 50 percent at fault, and the damages are in x amount. One-half of x would be paid by the contractor to the Government employee who has been injured.

The Government employee would have received Federal Employees Compensation Act or worker's compensation benefits, which would be recoverable by the United States ordinarily under present law out of that judgment by right of subrogation.

That lien for subrogation would be reduced by 50 percent, the amount of the Government's fault, so the Government could not recover all of the FECA payments to the employee. The employee then would end up with half of his FECA and half of the total judgment coming from the contractor.

The equity of this sort of approach seems to be about the greatest amount of equity that could be accomplished, it seems to me, because we do have that impediment that says the Government itself is not to be responsible for the recovery of payment of injuries directly, in addition to the benefits that are already provided to Government employees.

Now, if there is some lack of equity because we say the benefits provided to an injured Government employee are not sufficient, that is another issue. As far as equitable apportionment is concerned, it seems to me that this approach makes the greatest sense and provides the greatest equity for the injured party as well as for the Government contractor and the United States itself.

Senator GRASSLEY. Maybe one followup as a clarification. Would this allow the Government employee plaintiff to recover the same amount from the contractor and the Government's Compensation Program?

Mr. KINDNESS. There would still be an offset, but there is a situation where—let us take, instead of a 50–50 split, the Government was 80 percent at fault and the contractor was 20 percent at fault. The FECA benefits that had been paid to the employee would only be subject to the right of subrogation to the extent of 20 percent; that is, the Government could recover 20 percent of what it had paid the injured employee, but the other 80 percent of it would be the Government's proportion of fault, and therefore it could not be recovered.

On the other hand, the contractor does not have to pay that 80 percent. Let us say the benefits and the award of the jury were exactly the same amount; it would be a complete wash. What would be anticipated is that the recoveries in court would probably be higher than the amount of benefits, worker's compensation benefits, paid to the Government employee.

Therefore, there could be an overlap to the extent of saying that the injured employee does not get all that he is entitled to, as determined in the court case, but he does get to keep a proportionate part of what the Government has paid him in worker's compensation benefits.

Senator GRASSLEY. Congressman Feighan, many of the critics of this type of legislation say that this type of risk is just part of the normal process of doing business and that firms providing goods and services to the Government ought to be willing to assume this risk if they want the benefits from doing business with the Government.

So, I would like to have your reaction to that point of view because obviously your introduction of the bill provides some modification to that point.

Mr. FEIGHAN. Mr. Chairman, I think we have to recognize the unique circumstances that we are addressing, and that is a contractor for the Federal Government is meeting in most instances very rigid requirements and specifications of the contracting agency of the Federal Government.

In many of those circumstances, in fact, we look to potential contractors and ask them not to assume a fair or reasonable amount of risk, as they might in private sector negotiations. But, in fact, we ask them in some instances, actually, to act imprudently and to assume a risk that is disproportionate to their ability to meet in the event of some catastrophe.

I think recognizing that potential, there are strong equity arguments for the Federal Government trying to balance that concern, as well as to ensure that third parties who may suffer some injury are able to turn to the contractor as well as to the Federal Government for adequate compensation for the injuries that might be sustained.

I think that this legislation strikes that kind of balance. I think in addition to providing the kind of protection that I think we are all interested in assuring is available, I think it will have the effect of stimulating greater competition, stimulating more involvement by potential contractors in bidding for Government goods and providing for Government goods and services.

When contractors realize that they do not have the obligation anymore of assuming an irresponsible, at some points, if I could

say it that way, or certainly an unreasonable amount of risk, they, I think, will be more willing to participate in the larger pool of Federal contractors.

Ultimately, I think that, in fact, will reduce the costs of the operations of the Federal Government over the long term.

Senator GRASSLEY. I want to say thank you to both of you and excuse you because I know you have a busy session. You may want to introduce your counsel that you have with you for the record.

Mr. KINDNESS. Thank you, Senator Grassley. I would like to introduce Kevin Richardson, minority counsel of the Subcommittee on Administrative Law and Governmental Relations of the House Committee on the Judiciary.

Senator GRASSLEY. Congressman Feighan.

Mr. FEIGHAN. I would like to introduce Michael Burroughs, my legislative assistant for judiciary matters.

Senator GRASSLEY. OK. Thanks to all of you and we will look forward to keeping the dialog open as progress on this legislation proceeds. Thank you very much.

Mr. KINDNESS. Thank you very much.

Mr. FEIGHAN. Thank you, Mr. Chairman.

OPENING STATEMENT OF SENATOR CHARLES E. GRASSLEY

Senator GRASSLEY. Before I call the next panel, I would give an opening statement. Reference was already made by the chairman of the committee to the fact that several hearings on the appropriate allocation of third-party tort liability between the U.S. Government and its contractors were held by my subcommittee in 1982 and 1983.

I also introduced a bill in the last Congress to respond to the concerns that the current state of law on this issue may not operate in a totally fair manner. This bill has been reintroduced as S. 1254, and I already thanked the chairman for having the full Judiciary Committee conduct this hearing to consider two significant liability situations presently facing government contractors.

Of course, there has been some piecemeal treatment of liability problems by Congress over the years in such obvious high-risk ventures as nuclear facilities, unusually hazardous military research and development, and operation of the swine flu vaccine program.

This selectivity has given rise to questions of fairness in terms of the Government's relationship with all of its contractors, and has deflected Congress from a more comprehensive, uniform and equitable solution.

We have heard testimony that many small as well as large companies performing contracts find their potential exposure to liability is quite broad, while their right to obtain indemnification or contribution from the Government is restricted and often uncertain. S. 1254 is intended to provide a more workable and equitable arrangement for liability when the Government is at fault.

As a means of providing background on the Government fault issue, I cite the 1977 Supreme Court case already referred to by Chairman Thurmond and by Congressman Kindness involving Stencel.

Stencel was a small subcontractor from South Carolina. That company sought to obtain indemnification from the Government for liability incurred as a result of a personal injury suit brought by a military officer who had been injured when the ejection system of his fighter aircraft malfunctioned.

The Air Force had dictated the design of the system and Stencel contended that the malfunction resulted from a defect in the specifications. The court, however, ruled the Government was free from liability.

Now, section 4 of S. 1254 provides a mechanism by which a contractor is relieved of liability to the extent the contractor can prove the Government was actually responsible for the damages sustained.

Additionally, section 5 of the bill addresses the possibility of catastrophic liability arising out of products or services supplied pursuant to a contract. If a catastrophic accident or sequence of events results from a Government project, the liability, and even the defense costs alone arising from the ensuing claims, would easily exceed both the available insurance and the net worth of the supplying contractor.

This could, of course, spell financial disaster not simply for the contractors, but also for the victims who would be unable to obtain compensation from the contractors.

Section 5 of this bill permits agencies to indemnify when there may be losses arising out of risks defined as unusually hazardous or nuclear in nature, or liability that cannot be reasonably protected by insurance.

Now, people who have followed some of my activities in the Congress in the recent 3 years know that I have spent considerable time over these 3 years studying the procurement system, particularly in the defense industry, and challenging how that system currently operates.

Here, also, I am examining how the current system of fault operates and whether it best suits the public interest. I recognize that this issue is very complex and there are numerous interests to assess and, of course, there has to be a balance of those interests.

S. 1254 may not necessarily be the optimum statute that could be developed. Notwithstanding, I believe it can serve as a viable working document from which we can proceed to give deserved attention to this issue and strive toward achieving a consensus on its resolution much as Senator Thurmond stated just before he left the hearing this morning.

We have with us today a group of very distinguished witnesses both from within the Government and outside the Government. Of course, we have a very ambitious witness list, including four panels, and because of that we have the lighting system that will be set at 5 minutes.

And I would like to suggest that in order for us to get done at the time we have to finish, I will have to enforce that. So I want to remind everybody that their full statements will be inserted in the record, as is traditional. And if some of you are not prepared to summarize, while panels preceding you are testifying it would give you a chance to think in terms of the 5-minute regulation.

I would now like to welcome Mr. Richard Willard, and he represents the Department of Justice. Mr. Willard serves as the Acting Assistant Attorney General of the Civil Division. And I would also like to have Ms. Mary Ann Gilleece, who has testified before in her capacity as Deputy Under Secretary for Acquisitions Management in DOD.

It is my understanding that you were also going to be accompanied by Dennis Trosch. Is he around?

Ms. GILLEECE. Mr. Chairman, he is due momentarily. We had notified the committee he was unable to be here until after 10:30.

Senator GRASSLEY. That is fine, and when he comes we will want to welcome him to the witness table immediately.

I would like to extend my appreciation to all of you for taking the time out of your busy schedules to come to give this testimony and I would like to have you start with Mr. Willard and then Ms. Gilleece.

STATEMENT OF A PANEL CONSISTING OF RICHARD K. WILLARD, ACTING ASSISTANT ATTORNEY GENERAL, CIVIL DIVISION, U.S. DEPARTMENT OF JUSTICE, AND MARY ANN GILLEECE, DEPUTY UNDER SECRETARY FOR ACQUISITION MANAGEMENT, DEPARTMENT OF DEFENSE

Mr. WILLARD. Thank you, Mr. Chairman. As you have suggested, I will summarize my prepared statement on the understanding it will be submitted for the record.

It is a pleasure for me to be here today to discuss the question of providing indemnification for Government contractors for liability arising out of contracts with the United States. As you and Chairman Thurmond have mentioned, this has been the subject of legislation in previous Congresses, on which we have testified.

S. 1254, which was introduced last week, is similar to prior bills that have been introduced on the subject. We object to S. 1254 in its present form because we do not believe Government indemnification of contractor losses is the appropriate way to solve the problems faced by Government contractors because of changing tort liability.

However, we are anxious to work with the members of this committee and with other interested parties in trying to develop some kind of legislation that can address these very real problems in a way that would be acceptable to the administration.

Senator GRASSLEY. Well, then, that is a very positive response. Is that the way I am supposed to take that to Senator Thurmond's offer?

Mr. WILLARD. That is exactly what I intend, Mr. Chairman, and I would like to state briefly what I think the basis for that response is. The impetus for these legislative proposals is very legitimate and very real.

In the past few years, Government contractors have been faced with innovative theories of tort liability and the enormous growth in the size of awards which many juries and courts have been making.

Thus, the contractors are faced with two troubling trends in the tort system—a movement away from the fault-based system for de-

termining liability and the dramatic increase in damage awards, particularly in punitive or other non-economic damages.

The movement away from fault means that the inquiry is not directed at finding the wrongdoer, but only to ensuring that any person who has suffered injury is guaranteed some compensation. This means that businesses must pay damages whether they are at fault or not.

For example, the use of absolute or no-fault liability has been expanded greatly beyond its origins in liability for ultra-hazardous activities, and causation standards have become more relaxed.

Thus, a manufacturer may be assessed damages for injuries caused by a machine which was produced many years ago and has since been modified by the user, or damages may be assessed against a manufacturer even if a product is misused.

In reality, a decision to reallocate significant resources to compensate individuals lies behind many of these findings of liability. If our current schemes for providing for those who cannot take care of themselves—the disabled and others—are deemed to be inadequate, then the benefit program should be examined through the democratic process and not by a judiciary creating off-budget tort liability.

Similarly, the use of punitive and substantial noneconomic damages to compensate for injuries has increased dramatically. Once we go beyond readily measured, actual damages and determining the appropriate award, we leave courts with very little guidance in setting damage awards and we leave business shouldering a measure of damages which goes far beyond proven injury.

The primary beneficiaries of this expanded tort liability has not been the unfortunate, unless you count lawyers in that class. As you may know, a recent Rand Corp. study shows that in the asbestos litigation, lawyers' fees and legal expenses accounted for two-thirds of all the money that had been paid out in connection with that litigation.

In other words, the tort system is a tremendously inefficient method for increasing benefits to those who, like the disabled, we agree society has a responsibility to help. It is the movement away from a fault-based system toward one of universal, strict liability and the movement to greater use of punitive and other noneconomic damages which has revolutionized tort law jurisprudence and created many of these problems that government contractors are legitimately concerned about.

Now, while we recognize that these changes in the tort system have created problems for the contractors, we do not believe that indemnification is an appropriate response because it does not correct the underlying reasons for these problems.

In fact, indemnification by the Government may well worsen the problems. Providing government indemnification without otherwise addressing the problems giving rise to excessive tort liability will only pass these tort judgments to the deep pocket of the taxpayer.

Indeed, it may well cause the sizes of judgments to increase because of the seemingly unlimited resources of the government which would be available to pay judgments.

The proposal providing for a Government indemnification beyond a reasonable level of insurance provides little protection against

this phenomenon. The Government is simply not equipped to evaluate insurance needs in every contract. In general, the free market accomplishes this task efficiently and at minimum cost.

If the Government must become involved in these cases against contractors where indemnification is involved, it will also significantly increase the need for Government legal resources because Government lawyers will have to be assigned to these cases which under the present system are handled by the contractors and their attorneys.

The cost of indemnification to the Government admittedly is difficult to calculate. Obviously, coverage of a sudden disaster is a possible result of the legislation. The same kind of enormous liability which is faced by a contractor in a catastrophic situation also could have an enormous budget impact if it is simply transferred to the taxpayers.

In addition, we have the problem of the liability which is thought not to exist at present but which may develop in the future, and a good example of that is the exposure to asbestos liability.

For example, if broad indemnification legislation had been in effect at the time the asbestos manufacturers entered into contracts with the Government, the Government would now be faced with extraordinary liability. Johns Manville, the major manufacturer of asbestos, has estimated its exposure in asbestos litigation could run as high as $39 billion.

They also allege that the Federal Government is liable for 43 percent of the amount it has paid out in claims to date. So under an indemnification provision, the Government might be liable for up to $16.5 billion, and Johns Manville is only one of the asbestos manufacturers.

In conclusion, Mr. Chairman, we think the response to the problems faced by the contractors which should be given serious consideration is legislation dealing with the excesses of product liability as they affect Government contractors. We would be pleased to work with members of this committee and with other interested parties in trying to develop legislation responsibly to address these problems without simply transferring the problems from the backs of the contractors to the backs of the taxpayers.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT

OF

RICHARD K. WILLARD
ACTING ASSISTANT ATTORNEY GENERAL
CIVIL DIVISION
DEPARTMENT OF JUSTICE

Mr. Chairman and members of the Subcommittee:

It is a pleasure to be here today to discuss the question of providing indemnification for government contractors for liability arising out of contracts with the United States. This was the subject of legislation introduced in the 98th Congress (S. 1839, H.R. 4083 and H.R. 4199). Senator Grassley introduced S. 1254 on June 6 of this year, and Representative Kindness also reintroduced his bill as H.R. 1623. We object to S. 1254 because we do not believe that government indemnification of contractor losses is the appropriate way to solve the problems faced by government contractors because of changing tort liability. We have previously commented on similar proposals, including S. 1839 in the 98th Congress, which is identical to S. 1254. In those hearings and letters we addressed in detail the specific proposals in comments which we believe to be still valid. Without addressing the specifics of these bills, I would like to comment on the broader issues underlying these proposals, particularly the revolutionary changes in the tort law system which have so greatly expanded potential liability.

I.

At the outset, I would like to make clear the difference between the liability of the United States for indemnification in tort and in contract. The United States is liable for indemnification in tort to the same extent that it is liable directly in tort under the Federal Tort Claims Act. Under contract, the United States is liable for indemnification under

a contractual indemnification clause where the agency has the authority to indemnify a contractor and to the extent the agency's negligence caused the injury. Agencies may not expand indemnification clauses beyond this point without violating the Antideficiency Act, 31 U.S.C. §1341, and the Adequacy of Appropriations Act, 41 U.S.C. §11.

The United States, by virtue of its unique governmental role, necessarily engages in extrahazardous activities. In order to avoid unprecedented liability against the United States, Congress generally has taken care to provide that the United States is liable only when one of its employees was at fault. One of the few exceptions to that rule was the Swine Flu Act of 1976. P.L. 94-380, 94th Cong., 2nd Sess. Application of strict liability principles and other forms of vicarious liability or liability without fault are precluded under the FTCA.

II.

In the past few years, the efforts of government contractors to transfer their product liability exposure to the government has increased dramatically. Why, after all these years, are contractors so dissatisfied with the normal scheme? Two reasons clearly appear to be the innovative theories of tort liability applied by many courts, and the enormous growth in the size of awards which many juries and courts have been awarding of late. Thus, the contractors are faced with two troubling trends in the tort system -- the movement away from a fault-based system for determining liability, and the dramatic increase in damage awards, particularly in punitive and other noneconomic damages.

There are, indeed, many indications that tort law in the United States is moving away from a fault-based system which serves to deter socially harmful conduct, toward an absolute liability, insurance-type system which attempts to compensate every injured person, regardless of negligence or fault. Added

to this are increasingly large damage awards, which often go well beyond those damages needed to compensate the injured party for his or her actual losses.

Fault, of course, has been a centerpiece of tort law since the beginning of the industrial revolution. It is bottomed on the reasonableness of the actor's conduct or activities. Without fault, tort liability becomes no more than a judicially-imposed insurance scheme. Even strict liability in product liability law is grounded on fault; albeit a form of fault more generous to plaintiffs than traditional negligence.

Fault is not some archaic vestige of tort law to be jettisoned whenever it stands in the way of compensation. Ultimately, it is the only reliable vehicle in tort law for distinguishing socially beneficial, from socially harmful, conduct and activities. Without fault in tort law, we deter and punish those who do good -- those who are engaged in activities that benefit society. Fault represents the law's judgment that where certain activities benefit society as a whole, the law should not operate to inhibit those activities.

The movement away from fault means that the inquiry is not directed to finding the wrongdoer, but only to ensuring that any person who has suffered injury is guaranteed some compensation. This means that businesses must pay damages whether they are at fault or not. For example, the use of absolute, or no-fault, liability has been greatly expanded beyond its origins in liability for ultrahazardous activities. And causation standards have become more relaxed. Thus, a manufacturer may be assessed damages for injuries caused by a machine which was produced many years ago and since been modified by the user. Or, damages may be assessed against a manufacturer even if a product is misused. This is, in reality, simply a decision to reallocate significant resources to compensate injured individuals, regardless of any finding of wrongdoing. If our current shemes for providing for those who cannot take care of

themselves -- the disabled and the indigent -- are deemed to be inadequate, then the benefit programs should be examined through the democratic process, and not by a judiciary creating off-budget tort liability.

Similarly, the use of punitive and substantial noneconomic damages to compensate for injuries has increased dramatically. Punitive damages were originally used to punish particularly egregious or malicious conduct. Such damages have a place in a system which requires a finding of fault. Their purpose is to deter particularly wrongful conduct. To the extent the system is not based on fault, there may not be wrongful conduct to deter. Thus, we are assessing extra damages against parties who have done nothing wrong. Furthermore, these are damages which have no relationship to the need to compensate for actual damages. Similarly, awards of other forms of noneconomic damages are increasing dramatically. Once we go beyond readily measured, actual damages in determining the appropriate award, we leave the courts with little guidance in setting damage awards. And we leave business shouldering a measure of damage which goes far beyond any proven injury.

The primary beneficiaries of expanded tort liability have not been the unfortunate -- unless you count lawyers in that class. As you may know, a recent Rand study shows that lawyers' fees and legal expenses accounted for two-thirds of all the money that has been paid out in connection with asbestos litigation. In other words, the tort system is a horrendously inefficient method of increasing benefits even to those, like the disabled, whom we agree society has a responsibility to help.

It is the movement away from a fault-based system toward one of universal strict liability, and the movement to greater use of punitive and other noneconomic damages, which has revolutionized the tort law jurisprudence and has created these problems for government contractors.

III.

While we recognize that the changes in the tort system have created problems for contractors, we do not believe that indemnification is an appropriate response, and certainly it does not correct the underlying reasons for these problems. Indemnification by the government might well, in the short run, solve the problems faced by government contractors in the new world of tort liability; however, it will not solve the systemic problems in the long run and, indeed, may worsen these problems.

Providing government indemnification will only pass tort judgments to the "deep pocket" of the taxpayer. Indeed, it may well cause the size of the judgments to increase because the seemingly unlimited resources of the government will be available to pay judgments, and the little discipline imposed on the judicial system by the fact that a private defendant will have only limited resources available to meet judgments will no longer be present.

That the proposals have provided for government indemnification only beyond a reasonable level of insurance is, in reality, little protection. The government simply is not equipped to evaluate insurance needs in every contract. In general, the free market accomplishes this task efficiently and at minimum cost. The Department of Defense alone executed over twelve million contract actions in fiscal year 1982; it would be impossible to ensure that, in each case, adequate insurance is available. Government agencies lack the resources available to the insurance industry to make the highly complex decisions involved in determining risk and potential liability. Contractors and their insurers alone have access to the kind of information necessary to assess the appropriate levels of insurance. And, to the extent indemnification judgments are payable from the Judgment Fund, and not from agency budgets, it often may be in the interest of the agencies, which will have to

pay the cost of insurance premiums, to allow agency contractors to underinsure and thus pass their costs to the Judgment Fund.

Funthermore, indemnification removes the safety incentive created by the tort system. To the extent liability can be passed to the government, neither the contractors nor the insurers have a financial interest in ensuring that a product is designed and made with the safety of the user in mind.

In addition, massive indemnification of contractors would necessitate increased government supervision of contractor facilities and practices, a development which would hardly please the owners of the thousands of government contractors. Indeed, broad government indemnification only invites greater government control over the design and manufacturing practices of government contractors since, if the taxpayer is to pay for the liability, the government would need to ensure that this liability is kept to a minimum. Such indemnification also inevitably will increase the role of the government in the insurance industry as the government decides what are reasonable levels of insurance. To the extent these decisions are made after the fact of an injury, difficult litigation between the government, the contractors and the insurance companies would result, with little guidance to the courts on how to resolve such disputes.

If the government must become involved in suits against contractors where indemnification is involved, because the government must take over the defense of suits where the government will be ultimately liable, significant government legal resources will have to be assigned to these cases which, under the present system, are handled by the contractors.

The cost of indemnification to the government admittedly is difficult to calculate. Obviously, coverage of the sudden disaster is one possible result of this legislation. More problematical is the coverage of the liability which is now

thought not to exist, but, in a decade or may become quite significant. This problem arises, for example, from exposure to toxic substances which cause health problems after long latency periods. For example, had broad indemnification legislation been in effect at the time the asbestos manufacturers entered into contracts with the government to supply asbestos, the government would now be faced with an extraordinary liability. Johns-Manville, the major manufacturer of asbestos, has estimated its exposure in asbestos litigation to be from $1.9 billion to $39 billion. Since Johns-Manville alleges that the federal government is liable for 43% of the amount it has paid out in claims to date, under an indemnification provision the government might be liable for up to $16.5 billion. And Johns-Manville is only one of the asbestos manufacturers.

In any case, existing law now provides for indemnification in appropriate, carefully considered situations. See, for example, 10 U.S.C. §2354 (military research and development); 50 U.S.C. §§1431-1435 (P.L. 85-804) and 42 U.S.C. §2210 (Price-Anderson Act).

We think the one response to the problems faced by government contractors which should be given serious consideration is for Congress to pass legislation dealing with the excesses of product liability laws as they affect government contractors. The Administration has endorsed broad-based product liability reform. Since unreasonable awards against government contractors adversely affect the work of federal agencies, and, to the extent they are passed on to the government, represent a tax on federal activities, there is a clear justification for at least considering legislation to limit suits against government contractors. The Congress should consider the problem of the movement from a fault-based system by looking at the growing application of absolute, or no-fault, liability and the application of attenuated causation standards. The Congress should consider controlling the size

and incidence of punitive and other noneconomic damage awards. And Congress should consider the excessive transaction costs, particularly the size of attorneys' fees, and the possibility of using alternate dispute resolution devices to lessen the cost of the tort system. We believe a reasonable tort system will eliminate the problem faced by contractors, while maintaining an efficient and reasonable compensation for those who have been injured by wrongful conduct. With this sort of legislation, Congress will address the root cause of the contractors' complaints -- not merely pass the problem to the taxpayers.

Senator GRASSLEY. Mary Ann.

STATEMENT OF HON. MARY ANN GILLEECE

Ms. GILLEECE. Thank you, Mr. Chairman, and good morning again. We are pleased to be here to discuss the issue of contractor liability and indemnification. The subject of indemnification creates a difficult balance. The issue concerns, of course, whether the contractor should cover potential risks through insurance, or should the Government provide indemnification.

In the commercial world, risks of third-party liability are covered by insurance and are assumed by the manufacturer. In defense contracting, we believe this should also be the case, except for exceptional circumstances involving unusually hazardous or nuclear risks, which DOD does indemnify.

We are concerned that blanket indemnification may reduce the contractor's incentive to assume responsibility for the performance of their products by shifting part or all of the liability onto the Government.

The Department has serious reservations about the potential financial liability, as I indicated, and we believe that currently the laws which exist—10 U.S.C. 2354 and Public Law 85-804—are the laws which give us the authority which has been narrowly defined and strictly monitored, but we believe that is effective law for our purposes. These laws have served us well over the last 27 years.

Indemnification provisions are used by the Department in exceptional circumstances involving unusually hazardous or nuclear risks, and we have specifically defined those which are unusually hazardous or nuclear risks.

The use of indemnification provisions, as suggested by Congressman Kindness, by the Department has, in fact, been very unusual. In fact, in my statement we give the last 5 years and the statistics and, as he indicated, they are all under 100.

But as I also indicate, they are essential to procuring the Nation's defense systems. If we did not have the ability to indemnify contractors against extraordinary risks, some of the Nation's critical defense programs would not be executed.

When we operate at the leading edge of technology, we cannot expect the contractor to assume all the risk, particularly when hazardous and nuclear risks are involved. We believe our indemnification procedures are a necessity and that they are working well.

The Department believes that the current indemnification authorities are adequate and we are opposed to expanding the Government's financial liability without specific controls.

Mr. Chairman, that concludes my statement.

[The prepared statement follows:]

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STATEMENT

OF

MARY ANN GILLEECE

DEPUTY UNDER SECRETARY OF DEFENSE FOR ACQUISITION MANAGEMENT

OFFICE OF THE UNDER SECRETARY OF DEFENSE (RESEARCH AND ENGINEERING)

GOOD MORNING MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE. WE APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO DISCUSS THE "CONTRACTOR LIABILITY AND INDEMNIFICATION ACT."

THE SUBJECT OF INDEMNIFICATION CREATES A DIFFICULT BALANCE. THE ISSUE CONCERNS WHETHER THE CONTRACTOR SHOULD COVER POTENTIAL RISKS THROUGH INSURANCE OR SHOULD THE GOVERNMENT PROVIDE INDEMNIFICATION. IN THE COMMERCIAL WORLD, RISKS OF THIRD PARTY LIABILITY ARE COVERED BY INSURANCE OR ARE ASSUMED BY THE MANUFACTURER. IN DEFENSE CONTRACTING, WE BELIEVE THIS SHOULD ALSO BE THE CASE EXCEPT FOR EXCEPTIONAL CIRCUMSTANCES INVOLVING UNUSUALLY HAZARDOUS OR NUCLEAR RISKS WHICH DOD DOES INDEMNIFY. WE ARE CONCERNED THAT BLANKET INDEMNIFICATION MAY REDUCE THE CONTRACTORS' INCENTIVE TO ASSUME RESPONSIBILITY FOR THE PERFORMANCE OF THEIR PRODUCTS BY SHIFTING PART OR ALL OF THE LIABILITY ONTO THE GOVERNMENT. WE PREFER TO CONTRACT IN AN ENVIRONMENT SIMILAR TO THE COMMERCIAL MARKETPLACE WHERE COMPANIES MUST TAKE ALL THE STEPS THAT WOULD BE REQUIRED BY A PRUDENT BUSINESSMAN IN ORDER TO ENSURE THE SAFETY OF THE COMPANY'S PRODUCT.

THE DEPARTMENT OF DEFENSE HAS SERIOUS RESERVATIONS ABOUT THE POTENTIAL FINANCIAL LIABILITY RESULTING FROM WHOLESALE INDEMNIFIATION OF CONTRACTORS' LIABILITY. CURRENTLY THE DEPARTMENT OF DEFENSE HAS THE ABILITY TO INDEMNIFY CONTRACTORS UNDER 10 U.S.C. 2354 AND PUBLIC LAW 85-804. 10 U.S.C. 2354 DEALS WITH MILITARY RESEARCH AND DEVELOPMENT CONTRACTS AND PUBLIC LAW 85-804, IMPLEMENTED BY EXECUTIVE ORDER 10789, IS BROADER IN

SCOPE. BOTH STATUTES PERMIT THE INDEMNIFICATION OF CONTRACTORS UNDER APPROPRIATE CIRCUMSTANCES. THE USE OF THESE AUTHORITIES WITHIN DOD HAS BEEN NARROWLY DEFINED AND IS STRICTLY MONITORED. THESE LAWS HAVE SERVED US WELL OVER THE PAST 27 YEARS.

INDEMNIFICATION PROVISIONS ARE USED IN EXCEPTIONAL CIRCUMSTANCES INVOLVING UNUSUALLY HAZARDOUS OR NUCLEAR RISKS. ITEMS THAT FALL UNDER THE DEFINITION OF "UNUSUALLY HAZARDOUS" ARE GENERALLY THOSE ASSOCIATED WITH NUCLEAR-POWERED VESSELS, NUCLEAR-ARMED GUIDED MISSILES, EXPERIMENTAL WORK WITH NUCLEAR ENERGY, HANDLING OF EXPLOSIVES, OR PERFORMANCE IN HAZARDOUS AREAS. IN ADDITION, INDEMNIFICATION CLAUSES ARE INSERTED INTO ALL TRANSPORTATION CONTRACTS ENTERED INTO BY THE MILITARY AIRLIFT COMMAND FOR TRANSPORTATION SERVICES TO BE PERFORMED BY AIR CARRIERS THAT OWN OR CONTROL AIRCRAFT WHICH HAVE BEEN ALLOCATED BY THE DEPARTMENT OF TRANSPORTATION TO THE CIVIL RESERVE AIR FLEET. INDEMNIFICATION CLAUSES INSERTED INTO TRANSPORTATION CONTRACTS ARE AUTHORIZED BY PUBLIC LAW 95-163.

THE USE OF INDEMNIFICATION PROVISIONS IS VERY UNUSUAL. PROVISIONS TO INDEMNIFY CONTRACTORS AGAINST LIABILITIES BECAUSE OF DEATH OR INJURY OR PROPERTY DAMAGE ARISING OUT OF NUCLEAR RADIATION, USE OF HIGH ENERGY PROPELLANTS, OR OTHER RISKS NOT COVERED BY THE CONTRACTOR'S INSURANCE PROGRAM HAVE INDEED BEEN USED VERY SPARINGLY IN THE LAST FIVE YEARS:

CALENDAR YEAR	CONTRACTS
1980	65
1981	77
1982	93
1983	53
1984	50

TO PUT THESE NUMBERS IN PERSPECTIVE, THE DEPARTMENT OF DEFENSE EXECUTED OVER 14.8 MILLION CONTRACT ACTIONS IN FISCAL YEAR 1984. INDEMNIFICATION PROVISIONS WERE USED IN LESS THAN ONE THOUSANDTH OF ONE PERCENT OF THOSE CONTRACT ACTIONS.

ALTHOUGH INDEMNIFICATION PROVISIONS ARE USED RARELY, THEY ARE ESSENTIAL TO PROCURING THE NATION'S DEFENSE SYSTEMS. IF WE DID NOT HAVE THE ABILITY TO INDEMNIFY CONTRACTORS AGAINST EXTRAORDINARY RISKS, SOME OF THE NATION'S CRITICAL DEFENSE PROGRAMS WOULD NOT BE EXECUTED. WHEN WE OPERATE AT THE LEADING

EDGE OF TECHNOLOGY, WE CANNOT EXPECT THE CONTRACTOR TO ASSUME ALL THE RISK PARTICULARLY WHEN HAZARDOUS OR NUCLEAR RISKS ARE INVOLVED. WE BELIEVE OUR INDEMNIFICATION PROCEDURES ARE A NECESSITY AND THEY ARE WORKING WELL.

THE DEPARTMENT OF DEFENSE BELIEVES THE CURRENT INDEMNIFICATION AUTHORITIES CONTAINED IN 10. U.S.C. 2354 AND P.L. 85-804 ARE ADEQUATE. WE ARE OPPOSED TO EXPANDING THE GOVERNMENT'S FINANCIAL LIABILITY WITHOUT SPECIFIC CONTROLS.

THAT CONCLUDES MY STATEMENT. I WOULD BE HAPPY TO ANSWER ANY QUESTIONS THAT THE MEMBERS OF THE COMMITTEE MAY HAVE.

Senator GRASSLEY. First of all, Mr. Willard, I want to suggest that I appreciate your willingness to have you and your people work with us to try to reach a consensus, and I will follow up with that by having my staff contact you and other interested members of the committee to sit down to see what can be done in that area.

I have a question for both of you, but even though the question is not directed to you, if the other person wants to answer, I would invite that sort of response.

Mr. Willard, do you think that insuring against Government fault is a risk a contractor or subcontractor should reasonably assume as a part of his contractual bargain with the Government?

Mr. WILLARD. I think that is a legitimate problem and one that section 4 of the bill does attempt to address. I have to say that we have much less concern about that section of the bill than we do section 5, the indemnification provision.

There is a problem of unfairness where any party in tort litigation is held accountable for acts or omissions which are not that party's own fault. That is one of the reasons why, as I indicated in my prepared statement, we are concerned about the trend toward no-fault liability being imposed upon contractors.

By definition, we are also concerned about liability being imposed on contractors for the fault of some other party, including the Federal Government. So I think that there is a problem here.

We do have some concern that the precise provisions of section 4, however, could have a counterproductive effect on the relationship between the Government and its contractors. However, I think those problems can be worked with and addressed. And as I mentioned earlier, we are willing to work with the committee to see what can be done in this area.

Senator GRASSLEY. Also, I think it was at an earlier hearing I had before my subcommittee—at that hearing, we asked the Justice Department to supply any statistics or records compiled reflecting how many contractors have attempted to obtain contribution or indemnity from the Government.

At that time, your Department indicated no such records had been kept. Since that time, which was probably right now 2 years

ago, has the Justice Department kept records of such claims or conducted any studies to analyze the amount of activity in this area?

Mr. WILLARD. Mr. Chairman, I do not know whether we have the statistics or not, but I will be happy to go back and look for them and provide them for the record, if they exist.

Senator GRASSLEY. Now, in the next two panels we are going to hear testimony today that suggests this provision would not actually increase the costs to the Government because it merely reduces the Government's subrogation rights to the third-party judgment.

How does that balance with your statement that this provision would merely pass the problem to the taxpayers?

Mr. WILLARD. I do not believe section 4 would increase the costs to the Government to any significant extent, as it is written in the bill. That comment of mine was directed to section 5 rather than to section 4.

Senator GRASSLEY. From that standpoint in regard to section 5, then, as opposed section 4, would you explain in a little more detail how you come to that conclusion?

Mr. WILLARD. Well, basically, what section 5 requires is that the Government provide indemnification for tort liability of contractors under the conditions specified in section 5, either where the contract is unusually hazardous or nuclear or where the liability is in excess of a reasonable amount of insurance.

That happens even if the contractor's negligence is responsible for the liability. You were talking earlier about parties being liable for acts that are not their own fault, and while that is a legitimate concern in section 4, in section 5 it provides that the Government would be liable beyond these excess levels of insurance for acts even if caused by the negligence of the contractor.

There is an exception in there for willful misconduct or lack of good faith on the part of the top officials of the contractor, but ordinary negligence by any contractor employee or willful misconduct by a lower level contractor employee could cause the Government to be held liable. That would increase the cost to the Government if it is held liable under those circumstances.

Senator GRASSLEY. You mentioned as an alternative limiting the product liability of the Government contractors. What, more specifically, would you recommend along these lines that would protect the public interest, the Government's interest and the contractor's interest when the contractor is not at fault?

Mr. WILLARD. Mr. Chairman, there are three things that I think should be examined. One is a limitation of liability for Government contractors to acts which are their fault; that is, legislation that would overturn what has become a development in some areas of the country—a trend toward no-fault liability.

A second measure that we think should be examined is some kind of limitation on the amount of damages, particularly damages for noneconomic loss such as pain and suffering or emotional distress, as well as punitive damages, which in many cases can be quite large.

The final area that we think should be examined is the question of attorneys' fees and transaction costs, and whether it would be appropriate in some way to explore mechanisms for reducing the

rather large percentage of tort judgments which end up going to lawyers rather than to the intended beneficiaries.

Senator GRASSLEY. OK. Mary Ann, Government contractors have testified and will testify again today, or at least similarly today, that the current rate of indemnification is insufficient.

Now, in your statement you assert that the indemnification provisions were used in less than one-one thousandth of 1 percent of all DOD contracts executed in 1984. Can you provide any data or documentation that would back up the Defense Department's assertion that this amount of indemnity activity is adequate?

Ms. GILLEECE. Well, Mr. Chairman, essentially we know of no situation in which we have—well, indemnifying the contractor has actually paid them for a problem. I also indicated that 85-804 is available for the extracontractual relief.

Senator GRASSLEY. I should have said, too, unrelated to your answer, that I am also going to ask the other witnesses supporting this legislation if they can provide actual data which supports their position that indemnification procedures are too little used.

My purpose both in your question and in questioning them would be to go beyond just a judgment call with one side claiming the current is adequate and the other that it is not.

I have no further questions of either one of you, and I want to thank you very much for participating, and particularly for your summary in both instances to stay within the timeframes.

Ms. GILLEECE. Thank you, Mr. Chairman.

Senator GRASSLEY. Our next panel consists of Mr. Jeffrey Weinsten and he is president of Winfield Manufacturing Co. Winfield is a small business engaged almost exclusively in the manufacturing of clothing for the Department of Defense.

Simultaneously, we have Mr. T. Richard Brown. He is vice president of the electronic and defense sector for TRW. Mr. Brown represents approximately 12,000 manufacturing companies, 80 percent of which are classified as small business, and I would like to thank him for coming because he has been helpful in providing us information in the past.

And we also have Mr. James Perino and he represents Rockwell International. Mr. Perino serves as vice president of the pension insurance and risk management section at Rockwell, and he also has had to come quite some distance to participate with us, and we thank you very much for doing that.

I would ask all three of you to come and proceed in the way in which I introduced you. Would you introduce the fourth participant?

Mr. BROWN. Yes; I believe you know Mr. Souk. Mr. Souk has appeared in prior hearings, but for the record, he is Mr. Fred Souk, a partner in the Crowell & Moring law firm in Washington, who is a recognized expert in the knotty legal subjects and questions that are raised by this legislation, Senator.

Senator GRASSLEY. Jeffrey.

STATEMENT OF A PANEL CONSISTING OF: JEFFREY J. WEINSTEN, PRESIDENT, WINFIELD MANUFACTURING CO., ON BEHALF OF THE AMERICAN APPAREL MANUFACTURERS ASSOCIATION; T. RICHARD BROWN, VICE PRESIDENT, LAW DEPARTMENT, ELECTRONIC AND DEFENSE SECTOR, TRW, INC., ACCOMPANIED BY FRED SOUK, COUNSEL; AND JAMES J. PERINO, DIRECTOR, INSURANCE AND RISK MANAGEMENT, ROCKWELL INTERNATIONAL CORP., ON BEHALF OF THE CONTRACTOR LIABILITY AND INDEMNIFICATION ALLIANCE

Mr. WEINSTEN. Good morning, sir. In addition to being president of Winfield Manufacturing Co., I am also the vice chairman of the Government contracts committee of the American Apparel Manufacturers Association. We represent virtually every major company in the country which produces clothing for the U.S. Government. Approximately 99 percent of these businesses are small businesses.

I am pleased to respond to the committee's request for views concerning S. 1254. We in the apparel manufacturing industry are deeply concerned about the potentially massive liability involved in the production of military supplies and about our inability at this time to obtain an equitable sharing by the Government of the burden for paying for such liability. We are therefore delighted that this committee has been working to find a solution to unfair contractor liability burdens and we applaud the introduction of S. 1254.

Government contractors face two basic problems concerning tort liability arising from Government contract performance. First is the Supreme Court bar against contractors obtaining either contribution or indemnity from the Government.

The second problem is that many Government contracts for goods and services involve the possibility of catastrophic harm to vast numbers of people. The net result of the law is that even where the Government is totally or primarily at fault in causing a defect in a product or in misusing or altering a product, the contractor can be left to bear all liability without any Government participation or indemnity.

Two recent cases dramatize the effect of this situation. The first case involves the agent orange case. Another illustrative case involves the apparel industry, my industry. The survivors of a Navy officer who was killed at sea brought a product liability suit against Creighton, Inc., a manufacturer of uniforms for the military.

The officer had been killed when the boiler on his ship suddenly malfunctioned and spurted hot oil on him. He was wearing a polyester uniform manufactured by Creighton, completely in conformance with military specifications. The uniform melted.

In the lawsuit, the survivors alleged that he would not have been killed, only severely injured, if his uniform had not melted. They contended there was insufficient labeling in the uniform and that it was defective for foreseeable uses. Creighton, of course, had no control whatsoever over the label or the use of the shirt, but because of the *Stencel* doctrine Creighton was unable to bring a third-party suit against the Government alleging negligence for maintenance procedures.

In cases like Stencel, agent orange, and Creighton, the contractor can end up bearing liability to Government employees even though the Government was primarily or completely at fault in causing the harm.

Even if the Government fault problem were solved, contractors would still face a serious deterrent to becoming involved in Government procurement in light of the extraordinary amount of liability which can grow out of the supply of products and services for many types of Government programs. The agent orange litigation is a clear demonstration of that problem.

However, apparel manufacturers are certainly concerned as well. We are no longer just making pants and shirts. In fiscal year 1985, the Defense Logistics Agency will produce over 2 million articles of apparel coming from the 62 items specified as life and limb. They were all designed and tested by the Government before strict specifications were drafted.

The Government maintains special quality control requirements because life and limb items involve the expectation of serious risk to the user if the product is nonconforming. These garments may be fire protective, radioactive protective, ballistic protective, thermal shock protective, or chemical warfare protective, just to name a few.

I am particularly sensitive to these issues because my company is the major supplier of the chemical-protective suit. We have made over 5 million of these suits. The suit is designed by the Government and all the fabrics must conform to Government specifications.

But due to the secrecy in the chemical warfare protection program, I have absolutely no way of knowing if the suit is effective against chemical warfare agents. We have established quality control measures three times stricter than the Government requirements, but we use a gas simulant for our testing. This is the same simulant used by the Government labs.

Frankly, we are producing a product about which the Government requires that we follow its specifications blindly and trust that the Government has invented an effective product. Yet, the risk of liability falls completely upon us if the Government is wrong.

There are similar concerns by those people who are producing fragmentation vests and other garments designed for individual protection.

I see that the red light is on, so I will conclude now.

Senator GRASSLEY. Have you concluded?

Mr. WEINSTEN. Yes.

[The prepared statement follows:]

STATEMENT OF JEFFREY J. WEINSTEN

PRESIDENT

WINFIELD MANUFACTURING COMPANY, INC.

on behalf of the

AMERICAN APPAREL MANUFACTURERS ASSOCIATION

My name is Jeffrey J. Weinsten. I am President of Winfield Manufacturing Company, Inc., a small business engaged almost exclusively in the manufacture of clothing for the Department of Defense. I am also the Vice-Chairman of the Government Contracts Committee of the American Apparel Manufacturers Association (AAMA). The membership of the AAMA Government Contracts Committee includes virtually every major company in the country which produces clothing for the United States Government. Approximately 99% of these businesses are small businesses.

On behalf of my own company and the AAMA, I am pleased to respond to the Committee's request for views concerning S. 1254. We in the apparel manufacturing industry are deeply concerned about the potentially massive liability involved in production of military supplies and about our inability at this time to obtain an equitable sharing by the government of the burden of paying for such liability. We are therefore delighted that this Committee has been working to find a solution to unfair contractor liability burdens, and we applaud the introduction of S. 1254.

Government Contractor Liability Problems

Government contractors face two basic problems concerning tort liability arising from government contract performance. First, the Supreme Court has established a bar against contractors obtaining either contribution or indemnity from the government when they are sued in tort by government military employees injured by products or services supplied by the contractors. This bar applies even though the government may be at fault in causing the employee's harm. The bar against government contribution or indemnity can be especially unfair to contractors in situations where, under the ever-expanding doctrine of strict liability, they

can be held liable to injured government employees notwithstanding the fact that the government was solely responsible for causing the harm.

The second problem faced by contractors is that many government contracts for goods and services involve the possibility of catastrophic harm to vast numbers of people. Irrespective of who was at fault, the tort liability (or just the costs of litigation) which can arise from lawsuits brought by injured persons can be so great as to overwhelm any contractor, no matter how large, who is unfortunate enough to have been the supplier of the product or service which caused the harm. The net result can be financial disaster for such a contractor and an equally disastrous situation for injured persons who are unable to obtain compensation from the contractor.

The government now possesses statutory authority to indemnify its contractors for excessive liability which may arise from some contracting situations. However, the authority does not allow indemnification in all situations, and, perhaps more importantly, the government has been very inconsistent in agreeing to use the indemnification authority.

These two liability problems of contractors constitute a serious deterrent to any company's becoming involved in government procurement. A dramatic illustration of this unfortunate fact was provided at an oversight hearing held by this Committee's Subcommittee on Agency Administration on December 2, 1982. A spokesman for Dow Chemical Company, one of the world's largest chemical companies, after describing the severe liability problems experienced by Dow as a result of its previous participation in procurement, stated:

> As to any future role of The Dow Chemical Company under the present state of the law it should be noted that we have no contracts for research and development or production work on any chemical weapons. We would not seek that kind of business. Were the President to call on us to say that Dow's production of chemical weapons is a matter vital to the national security, we then, and only then, would make a decision about our involvement as a Government contractor. [Statement of Charles C. Carey, Senior Attorney, Dow Chemical Company, Hearings Before the Subcommittee on Agency Administration of the Committee on the Judiciary, United States Senate, Ninety-Seventh Congress,

Second Session, on Indemnification of Government Contractors (Comm. Print, 1983), at 130 (emphasis added).]

Government Fault

The contractors' problem of not being able to sue the government for contribution or indemnity when they are sued by government military employees derives from the case of Stencel Aero Engineering Corporation v. United States, 431 U.S. 666 (1977). In Stencel, a subcontractor attempted to obtain indemnity from the government for liability incurred as a result of a personal injury suit bought by a military officer who had been injured when the ejection system of his fighter aircraft failed to function properly. The government had established the specifications for the ejection system and had refused to change them when Stencel pointed out the problem which eventually led to the malfunction. The Supreme Court, however, ruled that contractors and subcontractors are barred from obtaining contribution or indemnity from the government when they are sued by military government employees.

The lower federal courts have frequently applied a similar principle when contractors have sought indemnity or contribution after being sued by civilian government employees. In the case of Lockheed v. United States, 93 S.Ct. 1033 (1983), however, the Supreme Court ruled that contractors are not barred from bringing suits for indemnity under the Federal Tort Claims Act ("FTCA") when they are sued by civilian government employees. Nevertheless, winning such a suit pursuant to the laws of most states (state law is applied pursuant to the FTCA) can be difficult in many situations.

The net result of the foregoing cases is that, even where the government is totally or primarily at fault in causing a defect in a product or in misusing or altering a product, the contractor can be left to bear all liability to government employees without any contribution or indemnity from the government. Two recent cases dramatize the effect of this situation.

The first case involves the Dow Chemical Company, and it is the case about which Dow was complaining at the aforementioned Senate hearing. Dow and eight other chemical companies were

recently involved in hundreds of lawsuits brought by ex-servicemen who served in Vietnam. Pursuant to government specifications, the companies produced a herbicide, known as Agent Orange, which was used by the military to defoliate the jungles in the Vietnam War. The servicemen claimed that their exposure to the herbicide has resulted in a variety of harmful effects on their health and has caused birth defects in their children. The companies were prevented by the Stencel case from bringing the government into the case to share in any liability which would ensue. The amount of damages claimed by the ex-servicemen exceeded the net worth of the defendants.

Another illustrative case involves the apparel industry. The survivors of a Navy officer who was killed at sea brought a product liability suit against Creighton, Inc., a manufacturer of uniforms for the military. The officer had been killed when the boiler on his ship suddenly malfunctioned and spurted hot oil on him. He was wearing a polyester uniform manufactured by Creighton in conformance with military specifications. The uniform melted. In the lawsuit, his survivors alleged that he would not have been killed, only severely injured, if his uniform had not melted. They contended there was insufficient labeling on the uniform and that it was defective for foreseeable uses. Because of the Stencel doctrine, Creighton was unable to bring a third party suit against the government alleging negligent boiler maintenance procedures.

In cases like Stencel, Agent Orange, and Creighton, the contractor can end up bearing liability to government employees even though the government was primarily or completely at fault in causing the harm. An ironic aspect of this situation is that the contractor can be held liable on a theory of strict liability, but the Supreme Court has ruled that the government itself cannot be held liable on such a theory when it is sued under the Federal Tort Claims Act. Laird v. Nelms, 406 U.S. 797 (1972).

This situation is obviously extremely unfair to contractors who participate in government procurement in good faith. Perhaps in recognition of this unfairness, some courts have begun to develop a doctrine which may alleviate some of the problem. This

new doctrine has come to be known as the "government contract defense" or the "government specifications defense."

The courts which have recognized the government contract defense have generally held that a government contractor sued by a government employee will be entitled to a complete defense to the liability claim if the contractor establishes three facts: (1) the specifications for the product causing the injury were established by the government; (2) the contractor met the specifications in every respect; and (3) the government knew as much as or more than the contractor about the hazards which might grow out of the product which the government specified. See Tillett v. J.I. Case Co., 756 F.2d 591 (7th Cir. 1985); Koutsoubos v. Boeing Vertol, Division of Boeing Co., 755 F.2d 352 (3d Cir. 1985); Bynum v. General Motors Corp., 599 F. Supp. 155 (N.D. Miss. 1984); Hubbs v. United Technologies, 574 F. Supp. 96 (E.D. Pa. 1984); McKay v. Rockwell International Corp., 704 F.2d 444 (9th Cir. 1983) cert. denied, __ U.S. __, 104 S.Ct. 711 (1984); McLaughlin v. Sikorsky Aircraft, 148 C.A.3d 203 (1983); In re "Agent Orange" Product Liability Litigation, 534 F. Supp. 1046 (E.D.N.Y. 1982); Brown v. Caterpillar Tractor Co., 696 F.2d 246 (3d Cir. 1982); Tefft v. A.C. & S., No. C80-924M (W.D. Wash., Sept. 15, 1982); Sanner v. Ford Motor Co., 144 N.J. Super. 1, 364 A.2d 43 (1976), aff'd, 381 A.2d 805 (1977); Hunt v. Blasius, 55 Ill. App.3d 14, 370 N.E.2d 617 (1977).

Unfortunately, it appears that the government contract defense will not develop into a meaningful resolution of the unfairness contractors presently face. A number of courts have rejected the defense or placed strict limitations on its application in various circumstances. See Nobriga v. Raybestos-Manhattan, Inc., 683 P.2d 389 (Haw. 1985); Hansen v. Johns-Manville Products Corp., 734 F.2d 1036 (5th Cir. 1984); Shaw v. Grumman Aerospace Corp., 593 F. Supp. 1066 (S.D. Fla. 1984); In re Air Crash Disaster at Mannheim, Germany on September 21, 1982, 586 F. Supp. 711 (E.D. Pa. 1984); Johnston v. United States, 568 F. Supp. 351 (D. Kan. 1983); Jenkins v. Whittaker Corp., 551 F. Supp. 110 (D. Hawaii 1982); Chapin v. Johns-Manville Corp., No. S79-0272(N) (S.D. Miss., Nov. 2, 1981); Challoner v. Day &

Zimmerman, Inc., 512 F.2d 77 (5th Cir. 1975); vacated on other grounds, 423 U.S. 3 (1975); Foster v. Day & Zimmermann, Inc., 502 F.2d 867 (8th Cir. 1974). Thus, for example, in the Creighton case discussed above, Creighton was unable to use the defense.

In light of the limitations being placed on the government contract defense and the uncertainty surrounding its development, we in the apparel industry believe that the most effective approach to solving the problem caused by the government's not having to share in paying liability caused by government fault is for Congress to enact legislation eliminating the unfair effect of the Stencel case.

S. 1254 would resolve the government fault problem by reducing contractor liability to government employees in proportion to government fault in causing their harm while at the same time reducing the government employee's obligation to repay worker compensation benefits. This approach achieves what we feel is a fair balance among all of the interests involved. It has the added benefit of avoiding government expenditures.

Catastrophic Liability

Even if the government fault problem were solved, contractors would still face a serious deterrent to becoming involved in government procurement in light of the extraordinary amount of liability which can grow out of the supply of products and services for many types of government programs.

The Agent Orange litigation is a clear demonstration of the problem. There, assuming that the plaintiffs could have established their allegations of a defective product, a number of major companies could literally have been bankrupted. For their cooperation in accomplishing an essential governmental task, the companies could have been called upon to pay the ultimate price while the government, which benefitted most from the task, stood by. Such a result is not consonant with good public policy. Not only is the result unfair to contractors, it also jeopardizes maintenance of an adequate industrial base for performance of essential governmental tasks.

In light of their potentially unlimited liability exposure, contractors who involve themselves in procurement for warfare, or

for the many other kinds of government programs which pose the risk, however slight, for causing extensive harm, are courting financial disaster unless they get indemnification from the government. Apparel-making companies are seriously concerned about their liability exposure even though at this time there may seem to be little likelihood that our products could cause massive amounts of harm.

In fiscal year 1985, the Defense Logistics Agency will purchase over two million articles of apparel coming from the 62 items classified as "Life and Limb." All of these items were designed and tested by the government before strict specifications were drafted. The government maintains verification lot acceptance and assures itself of superior quality control. These extra precautions are taken because "Life and Limb" items include the expectation of serious risk to the user if the product is nonconforming. These garments may be fire protective, radioactive protective, or chemical warfare protective, to name a few.

I am especially sensitive to these issues because my company is the major producer of the chemical protective suit. We have made over five million suits in the past and are currently working on two contracts for 950,000 suits. The suit is designed by the government and all the fabrics must conform to government specifications. Due to the secrecy in the chemical warfare protection program, I have no way of knowing if the suit is effective against chemical warfare agents.

We have established quality control measures three times stricter than government requirements, but we use a gas simulant for our testing. This is the same simulant used by the DPSC labs that test our product. We are producing a product about which the government requires we follow its specifications blindly and trust the government has invented an effective product. Yet the risk of liability falls completely upon us if the government is wrong.

Future warfare might involve battlefield use of exotic substances for which uniforms fail to provide protection as anticipated. Conceivably, this could result in massive numbers of lawsuits against my company or other apparel manufacturers. Similarly, the chemicals presently employed in the manufacture of

apparel, use of which experience has shown to be safe, may later be discovered to cause some kind of harm, perhaps in combination with substances encountered in warfare.

The government does have authority to provide indemnification in some circumstances. Under 10 U.S.C. § 2354, the military departments are allowed to indemnify contractors engaged in research and development programs for any liability arising from the direct performance of a contract and exceeding the amount of the contractor's insurance coverage. Indemnification is applied on a contract-by-contract basis and can only be applied if the risk associated with the contract is defined as being "unusually hazardous." Similarly, under Public Law 85-804, which is implemented by means of Executive Order 10789, all military agencies and certain civilian agencies may include indemnification clauses in any contract which facilitates the national defense. Once again, the risk involved must be identified as being "unusually hazardous" in nature.

Several problems have arisen with regard to these statutory authorizations for government indemnity. The indemnification authority is entirely optional with the government. Whenever military authorities, for whatever reasons, decide not to give indemnification, the contractor has no recourse. The indemnification can only be provided for risks defined as "unusually hazardous." This means that some risks which could result in catastrophic liability for the contractor will not be subject to indemnification simply because they cannot be characterized as "unusual." As a result, the provision of indemnification has been extremely limited and inconsistent. According to testimony by the Department of Defense before this Committee's Subcommittee on Administrative Practice and Procedure on October 18, 1983, DOD included a statutorily authorized indemnification clause in only one thousandth of one percent of its contracts in fiscal year 1982.

In the past, government agencies have sometimes voluntarily included indemnification clauses in contracts even though the conditions of 10 U.S.C. § 2354 or Executive Order 10789 were not met.

This practice, however, is no longer useful because the Comptroller General has ruled that such clauses violate the Anti-Deficiency Act and Adequacy of Appropriations Act to the extent that they obligate government funds in excess of appropriations available at the time payment of liability occurs. Assumption by Government of Contractor Liability to Third Persons, B-201072 (May 3, 1982), aff'd on reconsideration (May 12, 1983).

A variety of groups over the last twenty years have proposed legislation to establish a more comprehensive scheme for government contractor indemnification. In the early 1970's, the Commission on Government Procurement, which was established by Congress to review the procurement process, recommended such legislation. That recommendation has yet to be carried out. Two separate federal task forces have studied the problem. The latest task force, which was formed under the auspices of the Office of Federal Procurement Policy, prepared a report dated January 20, 1982 which recommended that Executive Order 10789 be amended to expand indemnification authority to any situation which could involve catastrophic loss (which the Report defined as liability above the level against which the contractor can reasonably protect through insurance). That recommendation has also not been carried out.

Quite clearly, a comprehensive solution to the catastrophic liability problem faced by government contractors is long overdue. We believe that Section 5 of S. 1254 provides a workable approach, and we urge this Subcommittee to work toward its enactment.

S. 1254 requires that government indemnification be provided for all contracts which involve the possibility of liability against which the contractor cannot reasonably protect through insurance. The bill should insure that contractors will be indemnified (above the level of available insurance) for all work on a variety of government programs such as those involving military action or preparedness, research and development, handling or use of potentially hazardous substances, and development or application of exotic or state-of-the-art technology. In this regard,

we believe that Congress should make it clear in enacting S. 1254 that the goal of the bill is to make indemnification available in every situation where it may be needed and that agencies should therefore resolve doubt over whether the possibility of excessive liability exists in favor of providing indemnification.

Conclusion

Companies desiring to participate in government procurement today are in many instances being asked by their government to throw caution to the winds. They are asked to run the risk of having to bear liability to government employees even though the government may be at fault. They are asked to run the risk of catastrophic liability, without any indemnification by the government, if something goes wrong.

The net result of these liability problems is that participation in the procurement process is strongly discouraged. This situation is bad for contractors and it is bad for the government. Ultimately, the government ends up paying more because of less competition for contracts. In some situations, the government ends up with a greater risk of something going wrong because the more foolhardy and less responsible companies have obtained contracts.

This unfortunate set of problems cries out for a solution. We believe that the legislation being considered by this Committee provides a solution. We commend you for your efforts on this important matter, and we stand ready to provide any assistance you may need in bringing your efforts to fruition.

Senator GRASSLEY. Go ahead.

STATEMENT OF T. RICHARD BROWN

Mr. BROWN. Senator, thank you again. I want to say that we are gratified by the substantial progress that was made on legislation in the last Congress. Once again, we express our appreciation to you for your efforts in bringing this topic to public and congressional attention.

I will not summarize the two prongs of the bill, since I think that has been done adequately by prior witnesses. I think our view is that the solution for the Stencel-type problem, while not perfect from a contractor's viewpoint, is certainly a reasonable accommodation and we have no difficulty with section 4 of 1254.

In the case of the catastrophic threat, we would back the requests of Congressman Feighan and Congressman Kindness that there be a comparison with the treatment of that issue with the bill that is pending on the House side, with particular attention to converting what under the current Senate bill would require a case-by-case contract determination and outguessing whether there is a significant liability potential in any particular contract, and going to essentially a self-executing or automatic indemnification, providing that the liability ultimately and whenever it may strike exceeds the insurance that is carried by the contractor or that is negotiated with the agency.

With respect to Mr. Willard's comments, if I can speak to those, we are encouraged that at least the Department of Justice has acknowledged that this is a legitimate problem. I think Mr. Willard said "a very legitimate and a very real problem", and that represents a concession that we have been arguing about for some time.

We are certainly willing to work with the Department of Justice, with your staff and with other interested parties in trying to come up with alternate approaches. But my great concern is that this issue has been kicking around for many long years and with many different ideas.

The propositions that Mr. Willard proposes to some extent would require radical departures from existing tort law, and while I think those should be explored and efforts made for accommodation, I think that one should not allow that to carry on for some unreasonable length of time. That may completely deter progress on the existing legislation, which at least we feel is responsive to our concerns, Senator.

With that, I think I will reserve time for your questions, sir.

[The prepared statement follows:]

STATEMENT OF

T. RICHARD BROWN

VICE PRESIDENT

LAW DEPARTMENT

ELECTRONIC AND DEFENSE SECTOR

TRW INC.

MY NAME IS T. RICHARD BROWN. I AM A VICE PRESIDENT IN THE LAW DEPARTMENT OF TRW INC., WITH OFFICES IN ROSSLYN, VIRGINIA.

THE UNITED STATES GOVERNMENT IS TRW'S LARGEST CUSTOMER. 1984 DIRECT SALES OR SALES THROUGH OTHER GOVERNMENT SUPPLIERS EXCEEDED TWO BILLION DOLLARS. TRW PRIMARILY SERVICES THE DEPARTMENT OF DEFENSE, THE NATIONAL AERONAUTICS AND SPACE ADMINISTRATION AND CLASSIFIED AGENCIES, BUT IT HAS ALSO PERFORMED CONTRACTS FOR A NUMBER OF CIVILIAN AGENCIES INCLUDING THE DEPARTMENTS OF ENERGY AND TRANSPORTATION.

AS A HIGH TECHNOLOGY ENTERPRISE, FREQUENTLY ENGAGED IN STATE-OF-THE-ART PROJECTS, TRW PRODUCES AND DELIVERS A NUMBER OF ITEMS THAT HAVE THE POTENTIAL FOR GENERATING SUBSTANTIAL THIRD PARTY LIABILITY. THIS TORT LIABILITY THREAT RELATES TO MONETARY CLAIMS WHICH COULD BE ASSERTED WHEN ACCIDENTS FLOWING OUT OF GOVERNMENT CONTRACT ACTIVITY CAUSE DEATH, INJURY, PROPERTY DAMAGE OR OTHER FINANCIAL LOSS.

CONTRACTORS HAVE RECOGNIZED THIS PROBLEM FOR MANY YEARS, BUT THEY ARE BECOMING INCREASINGLY APPREHENSIVE BECAUSE OF THE EXPLOSIVE GROWTH IN LITIGATION AND LARGE JUDGMENTS BEING RENDERED IN SUCH CASES, COUPLED WITH A DETERIORATING INSURANCE PICTURE AND A LACK OF RESPONSIVENESS ON THE PART OF CONTRACTING AGENCIES. IN RECENT YEARS, I HAVE CHAIRED TASK FORCES ESTABLISHED BY THE AEROSPACE INDUSTRIES ASSOCIATION AND THE NATIONAL ASSOCIATION OF MANUFACTURERS TO OBTAIN A WORKABLE AND COMPREHENSIVE SOLUTION. TODAY I APPEAR AS A REPRESENTATIVE OF THE CONTRACTOR LIABILITY AND INDEMNIFICATION ALLIANCE, A COALITION OF CONTRACTORS AND OTHER INTERESTED PARTIES FORMED TO SECURE REMEDIAL LEGISLATION GENERALLY ALONG THE LINES OF S. 1254.

THE BASIC ISSUE WE ARE ADDRESSING IS THE WILLINGNESS OF THE FEDERAL GOVERNMENT --

(1) TO ACCEPT RESPONSIBILITY FOR THE WRONGFUL ACTS OR OMISSIONS OF ITS EMPLOYEES, CIVILIAN AND MILITARY, AND

(2) TO CRAFT A FAIR DISTRIBUTION OF TORT LIABILITY WITH PRIVATE SECTOR CONTRACTORS AND SUBCONTRACTORS WHO SATISFY THE DEMANDS FOR A BROAD ARRAY OF PRODUCTS AND SERVICES THAT ENABLE THE GOVERNMENT TO FUNCTION.

I. THE LIABILITY RISK

IT IS A FACT THAT CONTRACTORS RESPONDING TO THE MULTIFOLD NEEDS OF THE UNITED STATES ARE ASSUMING -- KNOWINGLY OR OTHERWISE -- AN ONEROUS RISK OF TORT LIABILITY THAT MAY ARISE FROM ESSENTIAL PROGRAMS. IN CERTAIN AREAS, SUCH AS MILITARY ORDNANCE, HAZARDOUS WASTE DISPOSAL, SATELLITE LAUNCH/OPERATION AND AIR TRAFFIC CONTROL, THE HAZARD IS MANIFEST; IN OTHER OSTENSIBLY "SAFE" PURSUITS, UNPREDICTABLE OCCURRENCES MAY DEFY FORESIGHT AND PREVENTION. A REFUSAL TO ACKNOWLEDGE THE CONTRACTOR'S SUSCEPTIBILITY AND TO DEVELOP A POSITIVE RESOLUTION WILL BE CONTRARY TO THE GOVERNMENT'S LONG TERM INTEREST. SUGGESTIONS THAT THE RISK IS TOO REMOTE TO WARRANT ATTENTION, OR THAT SUCH A CONTINGENCY IS AN ORDINARY COST OF DOING BUSINESS OR THAT CONGRESS CAN DEAL WITH THE MATTER WHEN A DISASTER TAKES PLACE ARE SHORTSIGHTED CONTENTIONS AT BEST. SUCH VIEWS WILL INEVITABLY DISCOURAGE THE MOST RELIABLE CONTRACTORS FROM UNDERTAKING PERILOUS CONTRACTS, AND WILL DETER OTHER PROSPECTIVE CONTRACTORS, ESPECIALLY SMALL BUSINESSES, FROM COMPETING FOR GOVERNMENT WORK.

THE PROSPECT THAT A CONTRACTOR WILL BE OBLIGED TO UNJUSTLY SUSTAIN MATERIAL IF NOT RUINOUS THIRD PARTY LIABILITY SURFACES IN TWO DISTINCT SITUATIONS.

(A) GOVERNMENT FAULT

THE FIRST TYPE OF CASE TYPICALLY EVOLVES WHEN A GOVERNMENT EMPLOYEE SUSTAINS DEATH OR INJURY DUE TO A DEFICIENT CONTRACT SPECIFICATION, OR SOME MISUSE, ALTERATION OR IMPROPER CARE OF A CONTRACTOR-FURNISHED PRODUCT BY OTHER GOVERNMENT PERSONNEL. IF THE GOVERNMENT EMPLOYEE SUES THE GOVERNMENT, THE SUIT WILL BE DISMISSED ON THE GROUND THAT THE VETERANS' BENEFITS ACT OR FEDERAL EMPLOYEES' COMPENSATION ACT BASELINE THE LIABILITY OF THE UNITED

STATES FOR EMPLOYMENT-CONNECTED INJURY. THIS INESCAPABLY LEADS TO A CLAIM AGAINST THE CONTRACTOR.

UNDER THE SUPREME COURT HOLDING IN STENCEL AERO ENGINEERING CORP. V. U.S., 431 U.S. 666 (1977), A CONTRACTOR WHO INCURS LIABILITY TO A MILITARY EMPLOYEE IS FORECLOSED FROM SEEKING INDEMNITY OR CONTRIBUTION FROM THE GOVERNMENT SINCE -- AMONG OTHER REASONS -- THIS WOULD AMOUNT TO AN INDIRECT CIRCUMVENTION OF THE CONGRESSIONALLY-MANDATED CEILING ON GOVERNMENT LIABILITY TO PERSONS IN MILITARY SERVICE. IN A RELATED 1983 CASE INVOLVING A CIVILIAN GOVERNMENT EMPLOYEE, LOCKHEED AIRCRAFT CORP. V. U.S., 460 U.S. 190 (1983), THE SUPREME COURT DECIDED THAT THE FEDERAL EMPLOYEES' COMPENSATION ACT "EXCLUSIVE REMEDY" LANGUAGE DID NOT BAR A CONTRACTOR ACTION FOR INDEMNITY, BUT THE COURT ALSO HELD THAT THE CONTRACTOR'S ACTUAL ENTITLEMENT TO INDEMNIFICATION WOULD DEPEND ON APPLICABLE STATE LAW. SINCE THE LAW IN MOST STATES MAKES IT DIFFICULT FOR A THIRD PARTY (E.G., CONTRACTOR) TO OBTAIN INDEMNIFICATION OR CONTRIBUTION FROM AN EMPLOYER FOR HARM SUFFERED BY EMPLOYEES, THE LOCKHEED PRECEDENT IS OF DOUBTFUL BENEFIT TO CONTRACTORS.

STENCEL AND LOCKHEED VIVIDLY ILLUSTRATE THE PERPLEXING NATURE OF THE CONTRACTOR'S POSITION.

IN STENCEL, THE LIABILITY CONCEDEDLY ORIGINATED WITH AN AIR FORCE DIRECTION THAT STENCEL, A SMALL SOUTH CAROLINA SUBCONTRACTOR, FURNISH AN AIRPLANE PARACHUTE PACK TO COMPLY WITH A DEFECTIVE AIR FORCE DESIGN, NOTWITHSTANDING STENCEL'S EXPRESSIONS OF CONCERN ABOUT SAFETY. THE FAULTY PACK CAUSED DEATH IN ONE INSTANCE AND SERIOUS INJURY IN ANOTHER OF PILOTS WHO TRIED TO EJECT FROM DISABLED PLANES, AND EVENTUALLY THE AIR FORCE ORDERED A DESIGN CHANGE TO PREVENT A FURTHER REOCCURRENCE. IN LOCKHEED, THE WRONGFUL DEATH ACTION OF THE CIVILIAN GOVERNMENT EMPLOYEE ROSE OUT OF A CRASH OF A C-5A AIRCRAFT MANUFACTURED BY LOCKHEED. THE ILL-FATED PLANE HAD BEEN DELIVERED TO THE AIR FORCE MORE THAN FOUR YEARS BEFORE THE MISHAP AND THE GOVERNMENT DID NOT DISPUTE THE ALLEGATION THAT THE ACCIDENT WAS CAUSED BY IMPROPER GOVERNMENT MAINTENANCE.

THUS, WHILE THE LIABILITY EXPERIENCED BY STENCEL AND LOCKHEED WAS WHOLLY ATTRIBUTABLE TO GOVERNMENT FAULT, THEY WERE

EFFECTIVELY THRUST INTO THE ROLE OF INSURER OR GUARANTOR OF THE SAFE UTILIZATION OF THEIR PRODUCTS IN THE HANDS OF GOVERNMENT PERSONNEL. SEE ALSO HENRY V. TEXTRON INC., 577 F.2D 1163 (4TH CIR.), CERT. DENIED, 439 U.S. 1047 (1978).

BEYOND THE OBVIOUS INJUSTICE OF SADDLING CONTRACTORS WITH UNANTICIPATED COSTS IN PERFORMING THEIR CONTRACTS, THE RESULT DOES VIOLENCE TO BASIC PRINCIPLES OF TORT LAW. A FUNDAMENTAL PREMISE OF SUCH LAW IS THAT FINANCIAL ACCOUNTABILITY FOR HARM CAUSED TO OTHERS SHOULD BE BORNE BY THE PARTY WHO CONTROLS THE RISK. STENCEL AND LOCKHEED SHOW HOW A CONTRACTOR IS POWERLESS TO PREVENT LIABILITIES VISITED UPON IT BY THE GOVERNMENT. FOR CONTRACTORS SO AFFECTED (AND OTHERS WHO LEARN OF THE CONSEQUENCES), THERE IS A STRONG DISINCENTIVE FOR CONTINUED PARTICIPATION IN THE PROCUREMENT SYSTEM.

(B) CATASTROPHIC LOSS

THE OTHER CATEGORY OF LIABILITY PITFALL HAS BEEN LABELED "CATASTROPHIC" LIABILITY. THIS ENVISIONS AN OCCURRENCE OF SUCH DISASTROUS PROPORTIONS THAT RESULTING CLAIMS EXCEED REASONABLE AND AVAILABLE LEVELS OF LIABILITY INSURANCE OR SELF INSURANCE. CONSEQUENTLY, THE SURVIVAL OF THE CONTRACTOR MAY BECOME QUESTIONABLE AND INJURED PARTIES MAY WELL HAVE NO RECOURSE OTHER THAN TO PETITION CONGRESS FOR SPECIAL RELIEF.

IN LIGHT OF THE UNIQUE AND DIVERSE DEMANDS WHICH THE GOVERNMENT PLACES ON THE CONTRACTING COMMUNITY TO CREATE PRODUCTS HAVING THE CAPACITY TO CAUSE BODILY AND ECONOMIC HARM, NO ONE CAN DENY THAT THERE FREQUENTLY EXISTS AN IMPROBABLE BUT REAL CHANCE THAT FORTUITOUS, UNFORESEEN EVENTS COULD LEAD TO A MASSIVE LOSS. UNDER PRESENT LAW, EXCLUDING A FEW STATUTORY EXCEPTIONS, A CONTRACTOR WILL BE "HANGING OUT" TO THE EXTENT ANY INSURANCE IT MAY HAVE IS EXHAUSTED.

MORE THAN A DECADE AGO, THE COMMISSION ON GOVERNMENT PROCUREMENT ENDORSED THE IDEA OF LEGISLATION EMBRACING A NATIONAL POLICY THAT CONTRACTORS SHOULD AND WOULD BE SHIELDED FROM CATASTROPHIC LIABILITY WHICH EXCEEDED REASONABLE INSURANCE. COMMISSION ON GOVERNMENT PROCUREMENT, VOL. 4, pp. 99-103 (DEC. 1971). REGRETTABLY, DESPITE FREQUENT ITERATIONS OF SUPPORT FOR THIS RECOMMENDATION BOTH INSIDE AND OUTSIDE THE GOVERNMENT, NO ANSWER HAS BEEN FORTHCOMING. WE ARE, HOWEVER, EXCEEDINGLY PLEASED TO NOTE

THE PROGRESS MADE IN BOTH THE SENATE AND HOUSE IN THE 98TH CONGRESS, AND WE GENUINELY HOPE THAT LEGISLATION IS AT LONG LAST IMMINENT.

WITHOUT DOUBT, THE CONTRACTOR DISCOMFORT LEVEL HAS BECOME EXACERBATED OVER THE YEARS FOLLOWING THE COMMISSION'S PROPOSAL. THE BURGEONING PROPENSITY OF INJURED PARTIES TO SEEK RECOMPENSE IN THE COURTS IS A WELL-KNOWN PHENOMENON; SO TOO, THE DISPOSITION OF SYMPATHETIC JURIES TO AWARD LARGE DAMAGE VERDICTS. TRIAL ATTORNEYS AND THE JUDICIARY HAVE BEEN INSPIRED IN TURN TO DEVISE CREATIVE THEORIES FOR RECOVERY. AS AN EXAMPLE, THE DOCTRINE OF STRICT LIABILITY ALLOWS CLAIMANTS TO SUCCESSFULLY PROCEED AGAINST CONTRACTORS FOR HARM TRACED TO ASPECTS OF A CONTRACTOR'S PRODUCT IMPOSED BY GOVERNMENT SPECIFICATIONS.

II. CONTRACTOR ALTERNATIVES

IT IS INSTRUCTIVE TO CONSIDER WHAT OPTIONS A CONTRACTOR HAS AS IT STRIVES TO REDUCE THE UNCERTAIN EXPOSURE FROM THIRD PARTY LIABILITY.

(A) INSURANCE

WE AGREE THAT A CONTRACTING AGENCY SHOULD ALWAYS BE ABLE TO NEGOTIATE WITH A CONTRACTOR FOR THE RETENTION OF PRESCRIBED LEVELS OF INSURANCE, PROVIDING SUCH INSURANCE IS COMMERCIALLY OBTAINABLE (OR REALISTIC IN THE CASE OF SELF-INSURANCE). INSURANCE AGAINST LIABILITY RISKS IS NORMAL AND LOGICAL, BUT IT IS NOT A PANACEA. NOR IS THE COST TO BE PAID FOR INSURANCE AN IRRELEVANT ASPECT. THE SAFETY RECORD IN GOVERNMENT PROCUREMENT HAS BEEN EXCEPTIONALLY FINE. IT IS NOT SENSIBLE TO HAVE CONTRACTORS INSURE FOR A "WORST CASE" HAPPENSTANCE IN EVERY TRANSACTION. ADDITIONALLY, A MOUNTING LIST OF INSURANCE DISASTERS -- ASBESTOSIS, DES, DALKON SHIELD, LOVE CANAL, PLUMMETING AND NONFUNCTIONAL SATELLITES, BHOPAL — HAVE ALREADY GENERATED EXTRAORDINARY PREMIUM INCREASES AND STIMULATED SERIOUS INQUIRIES RELATIVE TO WHAT THE CASUALTY INSURANCE MARKET CAN BEAR IN TERMS OF WRITING COVERAGE AND ABSORBING CLAIMS LOSSES.

(B) PRICING

IN THE STENCEL DECISION, THE SUPREME COURT OBSERVED THAT STENCEL, A SMALL SUBCONTRACTOR, SHOULD HAVE TAKEN THE LIABILITY LOSS IT WAS FORCED TO BEAR (EVEN THOUGH THE LIABILITY ACCRUED SOLELY FROM GOVERNMENT FAULT) INTO ACCOUNT WHEN NEGOTIATING ITS CONTRACT. THE

IMPLICATION IS THAT CONTRACTORS AND SUBCONTRACTORS CAN AND OUGHT TO INJECT SOME CUSHION INTO THEIR PRICES TO COVER THE LIABILITY FACTOR. THOSE MORE KNOWLEDGEABLE ABOUT GOVERNMENT CONTRACTING WILL RECOGNIZE THIS AS WHOLLY IMPRACTICAL REASONING. GIVEN (i) THE GOVERNMENT'S PREFERENCE FOR FIXED PRICE, ADVERTISED CONTRACTS WHICH USUALLY RESULT IN AWARDS TO THE LOWEST BIDDER, (ii) REQUIREMENTS FOR CONTRACTOR CERTIFICATION OF COST AND PRICING DATA, (iii) PERENNIAL FUNDING CONSTRAINTS AND (iv) VARIOUS "AUCTIONEERING" TACTICS USED BY GOVERNMENT CONTRACT OFFICERS TO DRIVE CONTRACT PRICES DOWNWARD, IT IS FALLACIOUS TO BELIEVE THAT CONTRACTORS COULD EFFECTIVELY OFFSET THE LIABILITY SPECTRE BY ENLARGING BID OR PROPOSAL SUBMISSIONS, OR THAT AGENCIES WOULD WANT OR EXPECT CONTRACTORS TO DO SO. FURTHER, WHILE IT IS COMMON IN THE COMMERCIAL SPHERE FOR PRODUCERS TO SPREAD VARIOUS OPERATING COSTS — INCLUDING LIABILITY OR OTHER LOSS RESERVES — ACROSS A BROAD DOMESTIC OR INTERNATIONAL CUSTOMER BASE, GOVERNMENT CONTRACTORS SERVE A NARROW CLIENTELE AND TEND TO DELIVER RELATIVELY SMALL QUANTITIES OF END PRODUCTS.

(C) SPECIAL PURPOSE STATUTES

CONGRESS HAS PERIODICALLY ENACTED LAWS FOR IDENTIFIED HIGH RISK ENDEAVORS, WHERE IT WAS POLITICALLY CRITICAL TO INDUCE CONTRACTORS TO PERFORM IN THE FACE OF DEMONSTRABLE LIABILITY PERILS. HENCE, INDEMNIFICATION HAS BEEN APPROVED FOR (i) CONTRACTORS, SUBCONTRACTORS AND LICENSEES INVOLVED WITH NUCLEAR FACILITY CONSTRUCTION AND OPERATION, 47 U.S.C. § 2210 (1975), (ii) RESEARCH AND DEVELOPMENT CONTRACTORS OF MILITARY DEPARTMENTS PERFORMING "UNUSUALLY HAZARDOUS" RISKS, 10 U.S.C. § 2354 (1956), (iii) CONTRACTS FURTHERING THE NATIONAL DEFENSE IF THE WORK IS UNUSUALLY HAZARDOUS OR NUCLEAR IN NATURE, 50 U.S.C. §§ 1431-35 (1958), AS IMPLEMENTED BY EXECUTIVE ORDERS 10789 (1958) AND 11610 (1971), (iv) MANUFACTURERS AND OTHERS ENGAGED IN THE ADMINISTRATION OF SWINE FLU VACCINE, 42 U.S.C. § 247b. (1978) AND (v) NASA AGREEMENTS WITH USERS OF A SPACE VEHICLE, 42 U.S.C. § 2458b. (1979).

ONE MAY LEGITIMATELY ASK WHY THIS PATCHWORK OF STATUTORY BENEFICIARIES IS ANY MORE DESERVING OF INDEMNIFICATION THAN THE ENTIRE SPECTRUM OF CONTRACTORS WHO RESPOND IN GOOD FAITH TO

GOVERNMENT SOLICITATIONS. IF THE UNDERLYING OBJECTIVE IS TO ENCOURAGE CONTRACTORS TO COMPETE NOTWITHSTANDING THE LIABILITY ELEMENT, THEN THIS PROTECTION SHOULD NOT BE DEPENDENT UPON A CONTRACTOR'S GOOD FORTUNE IN FITTING INTO SELECTIVE NICHES WHICH CONGRESS HAS DELINEATED. THIS SELECTIVITY IS ALSO SEIZED UPON BY AGENCIES WHICH REASON RIGHTLY OR WRONGLY THAT CONGRESS HAS NOT SEEN FIT TO SANCTION INDEMNIFICATION OTHER THAN IN VERY SPECIFIC TYPES OF CONTRACT ACTIVITY.

(D) CONTRACT INDEMNIFICATION PROVISIONS

ABSENT EXPLICIT CONGRESSIONAL AUTHORIZATION, THERE HAVE BEEN LIMITED CIRCUMSTANCES IN WHICH CONTRACTORS HAVE CONVINCED CONTRACTING AGENCIES THAT IT IS DESIRABLE FOR THEM TO GRANT LIABILITY INDEMNIFICATION AS PART OF THE CONTRACTUAL BARGAIN. AGENCIES HAVE HISTORICALLY BEEN RELUCTANT TO AGREE, LARGELY OWING TO UNCERTAINTY OR AMBIGUITY REGARDING THE PERMISSIBILITY OF CONSENTING TO ANY SUCH COMMITMENT. AGENCIES DOUBTLESS FEEL EVEN MORE INHIBITED TODAY BECAUSE OF THE POSTURE OF THE COMPTROLLER GENERAL ON THE SUBJECT.

ACCORDING TO THE GAO, INDEMNIFICATION CLAUSES WHICH FOR YEARS HAD BEEN REGULARLY INSERTED IN MANY DEFENSE AND CIVILIAN CONTRACTS VIOLATE THE ANTI-DEFICIENCY ACT (31 U.S.C. § 1341) AND THE ADEQUACY OF APPROPRIATIONS ACT (41 U.S.C. § 11). SEE COMP. GEN. DECISION B-201072, MAY 3, 1982, AFFIRMED MAY 12, 1983. THESE RULINGS CHALLENGED BOTH DEPARTMENT OF DEFENSE AND CIVILIAN AGENCY REGULATIONS WHICH PROVIDED FOR GOVERNMENT ASSUMPTION OF UNCOMPENSATED CONTRACTOR LIABILITY TO THIRD PERSONS IN COST-REIMBURSEMENT SUPPLY AND RESEARCH AND DEVELOPMENT CONTRACTS. THE COMPTROLLER GENERAL STATED THAT THESE CLAUSES SHOULD NOT BE UTILIZED BECAUSE THEY PURPORT TO OBLIGATE GOVERNMENT FUNDS TO PAYMENT OF LIABILITIES UNDETERMINED AT THE TIME OF CONTRACTING, IRRESPECTIVE OF WHETHER THE ULTIMATE COST MIGHT EXCEED AVAILABLE APPROPRIATIONS.

UNDER THE NEW FEDERAL ACQUISITION REGULATION, INDEMNIFICATION IS SUBJECT TO THE AVAILABILITY OF APPROPRIATED MONIES AT THE TIME A CONTINGENCY OCCURS, AND NOTHING IS TO BE CONSTRUED AS A GUARANTEE THAT CONGRESS WILL APPROPRIATE THE NECESSARY FUNDS. SEE § 52.228-7, PARA. (d). THEREFORE, CONTRACTORS CONTINUE TO WRESTLE WITH A SPECULATIVE, UNSATISFACTORY CHOICE. AS MORE OF THEM BECOME

COGNIZANT OF THEIR VULNERABILITY — AND OF THE GOVERNMENT'S RELUCTANCE TO ACCEPT ACCOUNTABILITY — THE IMPACT ON THE PROCUREMENT PROCESS IS BOUND TO BE DISRUPTIVE. CONTRACTORS, PARTICULARLY SMALL BUSINESS CONCERNS, WHO ARE UNABLE TO SCOPE AND PROVIDE COVER FOR LIABILITY HAZARDS MAY ELECT TO DO BUSINESS ELSEWHERE. AND IF AGENCIES FEEL COMPELLED TO CONTRACT WITH SUPPLIERS WHO AGREE TO PROCEED WITHOUT REGARD TO THE LIABILITY ISSUE, THIS MAY DEPRIVE THE GOVERNMENT OF THE MOST COMPETENT AND SAFETY CONSCIOUS PERFORMERS AND LEAVE UNRESOLVED THE QUESTION OF GOVERNMENT RESPONSIBILITY FOR THE CONSEQUENCES OF A LIABILITY OCCURRENCE.

THIS ARBITRARY AND UNNECESSARY IMPEDIMENT TO ATTRACTING THE BREADTH AND BEST OF THE NATION'S INDUSTRIAL BASE ILL SERVES THE PUBLIC WELFARE. IT IS HARDLY ENLIGHTENED TO DECLARE THAT THE CONTRACTOR'S PROBLEM CAN BE OBVIATED BY DECLINING GOVERNMENT WORK.

(E) FEDERAL LEGISLATION

BASED ON THE FOREGOING, WE SUBMIT THAT THE ONLY SATISFACTORY ANSWER TO THE COUNTERPRODUCTIVE STATUS QUO IS A NEW STATUTE. IDEALLY, THIS STATUTE SHOULD TREAT CONTRACTORS UNIFORMLY AND SHOULD RECTIFY THE EXTANT INEQUITIES IN BOTH THE GOVERNMENT FAULT AND CATASTROPHIC LOSS AREAS. WE COMMEND THE JUDICIARY COMMITTEE FOR SETTING THIS HEARING WITH THE OBJECTIVE OF EXPLORING AND PROMULGATING A FUNCTIONAL STATUTORY REMEDY. WE PARTICULARLY WELCOME THE INITIATIVE OF SENATOR GRASSLEY IN INTRODUCING A BILL — S. 1254 — WHICH SEEKS A RESPONSIBLE AND PRAGMATIC APPORTIONMENT OF LIABILITY AS BETWEEN CONTRACTORS AND THE GOVERNMENT.

III. S. 1254

SECTION 4 OF S. 1254 WOULD ENABLE A CONTRACTOR WHO IS SUED BY A GOVERNMENT EMPLOYEE (OR THE EMPLOYEE'S REPRESENTATIVE) TO OBTAIN A DETERMINATION THAT THE HARM OR LOSS ON WHICH THE EMPLOYEE'S CLAIM IS BASED WAS CAUSED IN WHOLE OR PART BY THE FAULT OF THE UNITED STATES. TO THE EXTENT SUCH GOVERNMENT FAULT IS ESTABLISHED, THE CONTRACTOR WILL BE ENTITLED TO HAVE ANY JUDGMENT AGAINST IT PROPORTIONATELY REDUCED. CORRESPONDINGLY, THE INJURED EMPLOYEE WILL BE GRANTED PRO RATA RELIEF FROM THE GOVERNMENT'S RIGHT OF SUBROGATION ARISING

OUT OF ANY COMPENSATION PAYMENT RECEIVED BY THE EMPLOYEE FROM THE CONTRACTOR.

UNDER SECTION 4, IF THE HARM OR LOSS IS ATTRIBUTED SOLELY TO NEGLIGENT GOVERNMENT ACTIONS, THE CONTRACTOR WOULD INCUR NO LIABILITY TO THE PLAINTIFF. IF THE CONTRACTOR WAS FOUND TO BE EXCLUSIVELY RESPONSIBLE, NO REDUCTION OF LIABILITY WOULD RESULT. IF A COURT DECIDED THAT THE GOVERNMENT AND THE CONTRACTOR HAD BEEN EQUALLY AT FAULT, THE CONTRACTOR WOULD BEAR HALF THE JUDGMENT AWARDED.

IT SHOULD BE EMPHASIZED THAT THIS CONCEPT OF EQUITABLE REDUCTION WILL NOT LEAD TO ANY NEW OR INCREASED EXPENDITURES BY THE UNITED STATES. GOVERNMENT LIABILITY TO EMPLOYEE-CLAIMANTS WILL CONTINUE TO BE BOUNDED AND GOVERNED BY THE WORKER COMPENSATION SCHEMES ESTABLISHED BY THE VETERANS' BENEFITS ACT (MILITARY PERSONNEL) AND THE FEDERAL EMPLOYEES' COMPENSATION ACT (CIVILIAN PERSONNEL).

IN ACCEPTING THE SECTION 4 PROPOSITION THAT LIABILITY SHOULD TRACK ACTUAL FAULT, ONE SHOULD NOT MISTAKE THIS AS AN OPTIMUM SOLUTION FOR THE CONTRACTOR. UNDER MODERN LIABILITY DOCTRINES, A CONTRACTOR MAY WELL BE FOUND LIABLE TO A GOVERNMENT CLAIMANT WITHOUT EVIDENCE OF FAULT ON THE PART OF ANYONE. INJURED PLAINTIFFS ARE FREQUENTLY ABLE TO UTILIZE THE STRICT LIABILITY CONCEPT TO OVERCOME A LACK OF PROOF THAT THE DEFENDANT SUPPLIER WAS GUILTY OF A WRONGFUL ACT OR OMISSION. THAT IS, AN INJURED GOVERNMENT EMPLOYEE MIGHT RECOVER DAMAGES FROM A CONTRACTOR BY SHOWING THAT THE PRODUCT FURNISHED TO THE GOVERNMENT WAS DEFECTIVE, THE DEFECT EXISTED WHEN THE PRODUCT LEFT THE CONTRACTOR'S CONTROL AND THE DEFECT WAS THE CAUSE OF THE INJURY. SECTION 4 PERMITS A CONTRACTOR TO OBTAIN SOME DIMINUTION OF ITS LIABILITY ONLY IF IT IS ABLE TO DEMONSTRATE THAT FAULT OF GOVERNMENT PERSONNEL WAS A FACTOR. THIS MEANS A CONTRACTOR IS OBLIGATED TO LIVE WITH A MORE STRINGENT BURDEN OF PROOF VIS-A-VIS THE UNITED STATES THAN THAT BORNE BY A GOVERNMENT EMPLOYEE WHO PROCEEDS AGAINST THE CONTRACTOR. NEVERTHELESS, SINCE SECTION 4 CONSTITUTES A SUBSTANTIAL RESPONSE TO THE PRESENT PLIGHT OF THE CONTRACTOR, WE FIND IT A REASONABLE ACCOMMODATION.

WE DO DEEM IT DESIRABLE TO HAVE THE LEGISLATIVE HISTORY CLEAR ON ONE FEATURE. SINCE SECTION 4 IS CONFINED TO GOVERNMENT EMPLOYEE-CLAIMANTS, NO INFERENCE SHOULD BE DRAWN THAT A CONTRACTOR'S ABILITY TO SEEK GOVERNMENT INDEMNITY OR CONTRIBUTION IN CASES INVOLVING PRIVATE CLAIMANTS IS TO BE CHANGED OR DIMINISHED BY SECTION 4. EXISTING LAW ALLOWS CONTRACTORS TO PURSUE SUCH RELIEF CONSISTENT WITH THE FEDERAL TORT CLAIMS ACT WHEN GOVERNMENT FAULT BREEDS TORT CLAIMS BY NON-GOVERNMENT PARTIES. WE WANT TO PREVENT ANY MISINTERPRETATION THAT SECTION 4 IS INTENDED AS THE LONE RESORT FOR CONTRACTORS IN AMELIORATING LIABILITY CLAIMS ARISING FROM NEGLIGENT ACTS OR OMISSIONS OF THEIR GOVERNMENT CUSTOMERS. IT WOULD BE IRONIC IF S. 1254 WAS CONSTRUED TO PRESERVE THE DISCORDANT SITUATION PREVALENT TODAY, WHEREIN A CONTRACTOR'S RIGHTS FLUCTUATE WIDELY DEPENDING ON THE STATUS OF THE PERSON INJURED.

SECTION 5 OF S. 1254 TREATS CATASTROPHIC INCIDENTS BY AUTHORIZING CONTRACTING AGENCIES TO INSERT INDEMNIFICATION CLAUSES IN THEIR CONTRACTS WHEN

(a) THE CONTRACT INVOLVES GOODS OR SERVICES IDENTIFIED AS UNUSUALLY HAZARDOUS, NUCLEAR IN NATURE OR PRESENTING A POSSIBILITY OF LIABILITY THE CONTRACTOR CANNOT REASONABLY COVER BY LIABILITY INSURANCE OR SELF-INSURANCE, AND

(b) THE USAGE OF THE GOODS AND SERVICES BY THE GOVERNMENT IS NOT IDENTICAL IN NATURE AND SCOPE TO USES MADE BY NONGOVERNMENTAL CUSTOMERS OF THE CONTRACTOR.

THE SECTION 5 METHOD FOR DECIDING THE EXTENT OF GOVERNMENT INDEMNIFICATION LARGELY EMULATES THE PROCESS EMPLOYED UNDER EXECUTIVE ORDER 10789, AS AMENDED, WHICH IMPLEMENTS PUBLIC LAW 85-804, 50 U.S.C. §§ 1431-1435. AGENCIES WILL SET THE LEVEL OF FINANCIAL PROTECTION AN INDEMNIFIED CONTRACTOR MUST MAINTAIN, AFTER APPRAISING SUCH FACTORS AS THE AVAILABILITY, COST AND TERMS OF PRIVATE INSURANCE. INDEMNIFICATION WILL BE PROVIDED TO THE CONTRACTOR FOR ANY LIABILITY IN EXCESS OF THE AMOUNT OF FINANCIAL PROTECTION DESIGNATED IN THE CONTRACT. SIMILAR ARRANGEMENTS CAN BE NEGOTIATED BY A PRIME CONTRACTOR WITH ITS SUBCONTRACTORS, OR AMONG LOWER TIER SUBCONTRACTORS, CONSONANT WITH PROCEDURES ADOPTED BY THE CONTRACTING AGENCY.

UNDER SUBSECTION 5(b)(2), INDEMNIFICATION IS DENIED FOR LIABILITY OR CLAIMS CAUSED BY THE WILLFUL MISCONDUCT OR LACK OF GOOD FAITH OF A CONTRACTOR'S DIRECTORS, OFFICERS OR PRINCIPAL OFFICIALS. THIS CAVEAT -- WHICH IS IDENTICAL TO THAT CONTAINED IN EXECUTIVE ORDER 10789 -- SHOULD DEFUSE ANY FEAR THAT INDEMNIFICATION MIGHT ENCOURAGE CONTRACTORS TO DISREGARD SAFETY.

IV. COMPARISON WITH H.R. 1623

OUR PRINCIPAL RESERVATION ABOUT SECTION 5 OF S. 1254 — INDEED OUR MAJOR OBJECTION WITH RESPECT TO THE ENTIRE BILL -- PERTAINS TO THE REQUIREMENT FOR AGENCY DELIBERATION DURING NEGOTIATION OF A CONTRACT TO ASCERTAIN WHETHER IT IS APPROPRIATE TO INSERT AN INDEMNIFICATION PROVISION. ABSENT SUCH PROVISION, THE CONTRACTOR HAS NO PROTECTION. ALTHOUGH THE CONTRACTOR IS GRANTED A RIGHT OF APPEAL TO THE FEDERAL CIRCUIT COURT OF APPEALS IF IT DISAGREES WITH THE AGENCY RULING, PRESUMABLY A DENIAL OF INDEMNITY, TIME CONSIDERATIONS ALONE WILL LIKELY NEGATE THE EFFICACY OF THIS REMEDY.

DEBATE BETWEEN AGENCIES AND CONTRACTORS ON WHETHER A GIVEN CONTRACT TASK IS ELIGIBLE FOR SECTION 5 COVERAGE WOULD NOT ONLY DIVERT THE PARTIES FROM IMPORTANT CONTRACT PERFORMANCE ISSUES BUT RAISES THE POSSIBILITY THAT THE SALUTARY PURPOSES OF THIS LEGISLATION COULD BE SHORT-CIRCUITED. DISCRETIONARY INDEMNIFICATION CURRENTLY AVAILABLE UNDER PUBLIC LAW 85-804 HAS BEEN NEARLY IMPOSSIBLE TO ATTAIN BECAUSE AGENCIES HAVE CONSISTENTLY DISCOURAGED CONTRACTORS FROM AIRING THE LIABILITY RISKS WHICH THEY IDENTIFY.

WE BELIEVE THIS DILEMMA HAS BEEN RECOGNIZED AND EFFECTIVELY DEALT WITH BY A SIMILAR BILL PENDING ON THE HOUSE SIDE — H.R. 1623. WE ENCOURAGE YOU TO COMPARE SECTION 4 OF THAT MEASURE, WHICH ALSO SPEAKS TO THE TOPIC OF CATASTROPHIC LIABILITY. IN GENERAL, THE HOUSE VERSION MAKES INDEMNIFICATION AUTOMATIC AS TO ANY UNCOMPLETED OR FUTURE CONTRACT TO THE EXTENT THAT ULTIMATE LIABILITY EXCEEDS THE AMOUNT OF COMMERCIAL OR SELF INSURANCE AGREED UPON BY THE CONTRACTOR AND THE AGENCY, OR THE INSURANCE LEVEL OTHERWISE FOUND TO BE REASONABLE AT THE TIME LIABILITY IS INCURRED.

THIS SELF-EXECUTING APPROACH DISPENSES WITH THE NEED TO OUTGUESS WHETHER CATASTROPHIC LIABILITY COULD EVER ACCRUE UNDER A

SPECIFIC CONTRACT. IT ALSO ELIMINATES ANY LINGERING QUESTION REGARDING THE ROLE OF AGENCIES IN FACILITATING OR FENDING OFF THE APPLICATION OF INDEMNITY.

V. ADDITIONAL COMMENTS

WE THINK IT IS DESIRABLE TO MAKE CLEAR, EITHER IN THE STATUTE OR LEGISLATIVE HISTORY, THAT THIS ACT IS NOT MEANT TO MODIFY ANY ENTITLEMENT OR PRACTICE NOW AVAILABLE TO CONTRACTORS BY WHICH REIMBURSEMENT MAY BE OBTAINED FOR THEIR INSURANCE COSTS, INCLUDING COVERAGE FOR LIABILITY RELATED TO PRODUCTS OR SERVICES SUPPLIED PURSUANT TO GOVERNMENT CONTRACTS.

AS A FINAL DRAFTING POINT, WE NOTE A VARIANCE BETWEEN THE TYPES OF LIABILITY ENCOMPASSED IN THE DEFINITION OF "HARM" IN SECTION 3(7) AND THOSE CITED IN SECTION 5(b)(1)(A)-(C). IT APPEARS THAT THE LATTER LANGUAGE WAS DERIVED FROM EXECUTIVE ORDER 11610, WHICH AMENDED EXECUTIVE ORDER 10789. GIVEN THE INTENT TO RELIEVE CONTRACTORS FROM EXCESSIVE LIABILITY, WE RECOMMEND THAT SECTION 5 BE MODIFIED TO MATCH THE SLIGHTLY BROADER DESCRIPTION OF POTENTIAL LOSS WHICH IS EMBODIED IN THE SECTION 3 DEFINITION.

VI. BENEFITS OF NEW LEGISLATION

HAVING BEEN CLOSE TO THIS TOPIC FOR NEARLY TEN YEARS, I AM CONVINCED THAT ENACTMENT OF A NEW STATUTE ALONG THE LINES OF S. 1254 AND H.R. 1623 WILL PRODUCE SIGNIFICANT ADVANTAGES FOR CONTRACTORS, CONTRACTING AGENCIES, CONGRESS AND AMERICAN TAXPAYERS. IN MY OPINION, CRITICISM THAT THIS WOULD INADVISEDLY OPEN THE DOOR TO UNTOLD GOVERNMENT COST IS WITHOUT FOUNDATION.

WITH RESPECT TO THE CORRECTION MADE TO RELIEVE CONTRACTORS FROM THE CONSEQUENCES OF GOVERNMENT FAULT, THE EQUITABLE REDUCTION APPROACH ADOPTED IN BOTH S. 1254 AND H.R. 1623 SAFEGUARDS THE CONTRACTOR WITHOUT ENLARGING THE LIABILITY OF THE GOVERNMENT TO ITS EMPLOYEES. LOOKING AT CATASTROPHIC LOSS INDEMNIFICATION, IT IS ACCURATE TO SAY THAT NO ONE CAN PROGNOSTICATE WHETHER AND WHEN A DISASTROUS OCCURRENCE COULD BEFALL AND RESULT IN INDEMNIFICATION OUTLAYS. WE KNOW THAT THERE HAVE BEEN REMARKABLY FEW MAJOR

INCIDENTS IN THE PERIOD SINCE WORLD WAR II, BUT NO ONE CAN BE SURE OF A REPETITION OF THAT EXPERIENCE IN THE NEXT FORTY YEARS. NONETHELESS, IT IS IMPORTANT TO APPRECIATE THAT THERE WILL BE ABSOLUTELY NO BUDGETARY IMPACT UPON PASSAGE OF THIS LEGISLATION. AND WHATEVER THE POTENTIAL FOR DOWNSTREAM INDEMNIFICATION EXPENDITURES MAY BE, THAT CONTINGENCY MUST BE WEIGHED AGAINST THE BENEFITS TO BE DERIVED FROM HAVING IN PLACE A PROGRESSIVE AND PRUDENT INDEMNIFICATION POLICY.

PASSAGE OF EVENHANDED LEGISLATION WILL YIELD BENEFICIAL RETURNS AS FOLLOWS - .

(a) CONTRACTORS WILL BE BETTER ABLE TO ASCERTAIN THEIR COSTS OF PERFORMANCE BY NOT HAVING TO CONSIDER THE RISK ASSOCIATED WITH UNMEASURABLE THIRD PARTY LIABILITY. THIS WILL INDUCE THEM TO BID ON, AND PRICE MORE DISCRIMINATELY, CRUCIAL GOVERNMENT PROJECTS THAT POSE LIABILITY JEOPARDY.

(b) CONTRACTING AGENCIES WILL ENJOY THE GAINS -- FINANCIAL AND PROGRAMMATIC -- TO BE REAPED FROM ENHANCED COMPETITION. THEY WILL HAVE A BETTER APPRECIATION FOR WHAT CONGRESS INTENDS IN THE WAY OF INDEMNIFICATION. FURTHER, DIRECT SAVINGS MAY BE OBTAINED BY TELLING A CONTRACTOR TO FOREGO SPECIAL OR EXCESS LIABILITY INSURANCE WHEN THE AGENCY DECIDES THAT THE COST FOR SAME WOULD BE EXORBITANT.

(c) BY PROMULGATING AN ORDERLY SYSTEM FOR SATISFYING CLAIMS OF PARTIES WHO SUSTAIN LOSSES ARISING OUT OF GOVERNMENT CONTRACTS, THERE IS A GREATER LIKELIHOOD THAT CLAIMANTS WILL NOT BE LEFT UNCOMPENSATED BY REASON OF A CONTRACTOR'S INABILITY TO FINANCIALLY RESPOND TO LIABILITY AWARDS.

(d) CONGRESS WILL AVOID THE TIME, EFFORT AND POLITICAL PRESSURE ASSOCIATED WITH INNUMERABLE PRIVATE RELIEF BILLS INTENDED TO REDRESS OR COMPENSATE FOR INDIVIDUALIZED OCCURRENCES, E.G., CONTRACTOR HARDSHIP (STENCEL), ENORMOUS CLAIMS (TEXAS CITY), OR PROJECTS WHERE CONTRACTORS REFUSE TO PERFORM WITHOUT GOVERNMENT LIABILITY INSULATION (SWINE FLU VACCINE).

(e) LEGISLATION WILL REFLECT THE SENSE OF CONGRESS THAT THE GOVERNMENT MUST DEAL FAIRLY WITH ITS CONTRACTORS AND ACKNOWLEDGE ITS PARAMOUNT ROLE IN (i) INITIATING AND FOSTERING PROGRAMS ESSENTIAL TO A FUNCTIONING NATION, AND (ii) SUSTAINING A RESPONSIVE AND RESPONSIBLE BODY OF CONTRACTORS TO FULFILL THOSE PROGRAMS.

AS STATED PREVIOUSLY, ACTION ON THIS SUBJECT IS OVERDUE. WE URGE THE COMMITTEE TO MOVE AHEAD EXPEDITIOUSLY. IF WE CAN BE OF ANY ASSISTANCE, PLEASE CALL UPON US.

THANK YOU FOR THE OPPORTUNITY TO PRESENT THIS TESTIMONY.

Senator GRASSLEY. Mr. Perino.

STATEMENT OF JAMES J. PERINO

Mr. PERINO. Thank you, Mr. Chairman. Today, I am representing the Contractor Liability and Indemnification Alliance, a coalition of contractors and other interested parties. We appreciate the opportunity to appear here today before you and offer our strong support for the legislation that you introduced, Senate bill 1254. We commend you for reintroducing this vitally needed legislation and look forward to working with you and the committee to seek its enactment.

In the past, I have been privileged to work on the insurance and indemnity requirements of projects vital to the U.S. Government, such as the space shuttle, the B-1 combat aircraft, various propulsion systems for expendable launch vehicles, and the global positioning satellite.

As such, we have determined in our minds that although the insurance industry has been historically relied upon to respond to catastrophic losses, the nature of the liability exposure represented by the systems supplied to the U.S. Government far exceed the ability of the insurance industry to respond.

While the probability of such an incident is remote, the magnitude of loss could be potentially ruinous to the contractors. For these reasons, insurance is not the appropriate method of protecting the contractor for liabilities arising out of the production of military and other systems.

This is not an indictment of the insurance industry, but rather a conclusion reached after considering the elements of the insurance mechanism, the structure of the insurance market, and conditions contained in product liability insurance policies.

Insurance has to be based on governing principles, just as any other business discipline is, and an insurance underwriter is separated from a gambler because he does recognize these accepted principles.

In order for an insurance underwriter to make a profit, he must work with a large number of homogeneous units that are free of the catastrophic exposure. This element is essential so that he can

predict the losses that he will assume and have a fair, reasonable expectation of a profit.

I submit that these principles are absent in most Government contracting efforts of companies represented here. A very prime example is that of the space shuttle. There are exactly four units over which to spread the risk, and I submit that it is actuarily impossible to do so. I know of no actuarial techniques that will allow an insurance underwriter to predict the losses arising out of four units.

Furthermore, the payload alone represents a catastrophic loss in excess of $2 billion. This would be the value of the payload and the contingency of lost revenues to the payload owners. The $2.1 billion does not consider damage to the crew, damage on the ground, and other damages that would be sustained by organizations that would use these elements, such as Ted Turner and Home Box Office.

Senator GRASSLEY. Have you finished your thought?

Mr. PERINO. Far from it.

Senator GRASSLEY. Why do you not summarize? Just take a minute to summarize.

Mr. PERINO. I would think it would be very, very important to realize that product liability insurance that protects contractors is written on an occurrence basis. There is a need for the contractor to renew the policy or the policies each and every year so long as his product has a useful life.

The policy written for any one particular period covers not only the production from that current period, but that contractor's total backlog of production from whenever he began business, so that if a contractor was in business for 40 years, he has 40 years' worth of production to protect every year.

The availability of insurance is a very real question. Today, for example, the maximum amount of nonaviation product liability insurance available is $150 million in the world market.

The message that we have is that the insurance mechanism is not the proper mechanism to provide catastrophic protection to the defense and other military contractors for the Government production.

Thank you.

[The prepared statement follows:]

STATEMENT OF
JAMES J. PERINO
REPRESENTING
THE CONTRACTOR LIABILITY & INDEMNIFICATION ALLIANCE
CONCERNING
S. 1254, CONTRACTOR LIABILITY AND INDEMNIFICATION ACT
BEFORE THE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

JUNE 11, 1985

Mr. Chairman and Members of the Committee:

I am James J. Perino, Director of Insurance and Risk Management of Rockwell International Corporation. Today, I am representing the Contractor Liability and Indemnification Alliance (CLIA), a coalition of contractors and other interested parties.

CLIA appreciates the opportunity to appear here today to offer our strong support for the legislation that Senator Grassley introduced on June 6, S. 1254, the Contractor Liability and Indemnification Act. We commend Senator Grassley for re-introducing this vitally needed legislation and look forward to working with the committee to seek its enactment.

Historically the insurance industry has been relied upon to respond to catastrophic losses. However, the nature of the liability exposure represented by the systems supplied to the U.S. Government far exceed those of consumer or industrial products and in all likelihood exceed the ability of the insurance industry to respond. While the probability of such an incident is remote, the magnitude of a loss could be potentially ruinous to the contractor. For these reasons, insurance is not the appropriate method of protecting the contractor for liabilities arising out of the production of military and other systems. This is not an indictment of the insurance industry but rather a conclusion reached after considering the elements of the insurance mechanism, the structure of the insurance market, and the conditions contained in product liabilty insurance policies.

The Insurance Mechanism

The generally accepted requirements of an insurable risk are:

(a) large number of homogenous units, all subject to the same exposure,

(b) the loss must be fortuitous and independent,

(c) it must be definite in time and place, and

(d) non-catastrophic.

These principles separate insurance from gambling and make fortuitous losses predictable when large numbers are pooled. In this manner insurance underwriters can assume risks, which individually are unpredictable, as a business venture with reasonable profit expectations. In military and other systems contracting there are not a large number of homogenous units over which to spread a loss and they are subject to a catastrophic exposure. Clearly then, the insurance mechanism is not suitable to provide financial protection to government contractors for catastrophic losses arising out of systems supplied to the U.S. Government.

The Insurance Market

That segment of the insurance market engaged in providing coverage to government contractors is limited due to the fact that few underwriters have the resources necessary to underwrite and assume the risks presented. This restricted market is aggravated by the fact that several contractors participate in the production of one system. Accordingly, a single underwriter or group of underwriters may have liability for several contractors exposed to risk arising out of a single system. This accumulation of liability could exceed the insurance underwriters financial capacity to respond to a catastrophic loss arising out of that system.

Those few insurance underwriters who insure liability risks for government contractors are primarily supported in the U.S. by reinsurers and in London by "names" at Lloyds. The reinsurance business in the U.S. is characterized by a large group of small, thinly capitalized companies. There are less than 12 reinsurance companies in the U.S. with insurance revenues exceeding $100 million per year. The remainder of the U.S. reinsurers have revenues of less than $50 million per year. At Lloyd's, the "names" are individuals who must assume unlimited liability for their undertaking. However, their unlimited liability is diminished by the financial requirement of assets for a Lloyd's name of only $125 thousand for a citizen of the United Kingdom and approximately $175 thousand for others. Therefore, this market is also thinly capitalized.

Due to the fragmented, thinly capitalized nature of the insurance market and the catastrophic potential for liability losses, the market expands and contracts periodically. For example, two years ago, it was possible to procure in excess of $500 million of insurance protection for non-aviation products at an annual premium of approximately $2 thousand per million. Today, there is no more than $150 million of such insurance available with additional restrictions in coverage at a cost of approximately $15,000 per million. Consequently, the availability and price of insurance protection available to a contractor for military and other systems is uncertain.

Conditions of Insurance Policies

Products liability insurance policies have several common features:

1. They cover a one-year period and must be renewed by the contractor annually to remain in effect.
2. They cover all occurrences involving existing products that may occur during the one-year policy period, whether a product was built during that year or in previous years.
3. There is a liability limit for each occurrence.
4. There is a total liability limit for all occurrences combined in any one policy year.

Thus, for liability insurance purposes, it doesn't make any difference when a product is built. The only policy that covers products liability, regardless of the date of manufacture, is the policy in effect at the time of the occurrence. No earlier policy applies.

The one-year policy covers each occurrence during the policy period, subject to the liability limit per occurrence. However, one catastrophic occurrence early in a policy year could possibly exhaust the total liability limit for that year, leaving the contractor without further financial protection for the remainder of the year.

For these reasons, the financial protection provided by product liability insurance is not adequate to protect the contractors against a catastrophic loss arising out of military and other systems supplied to the U.S. Government.

S. 1254, therefore, is vitally needed legislation. It will provide the indemnification needed to prevent the deterrence of conscientious contractors from participating in essential procurements involving catastrophic risk.

Again, we want to thank you for permitting the CLIA to express our views to you today and we would be pleased to address any questions you might have.

Senator GRASSLEY. Now, I have a series of questions here and I do not want to direct to just any one of you of the three. On the other hand, maybe all of you do not have to respond to each one. In fact, I would probably have to say you do not have to, but that does not preclude—I am not going to designate the person to respond or limit the number of people that would respond to each one. Where you feel you can add to the answer to a question, please feel free to do that.

Do Government contractors already have a defense to suits brought by Government employees based on compliance with specifications accompanying Government contracts?

Mr. BROWN. I think that deals with the Government contractor defense, which is a legal issue, so I would defer to Mr. Souk.

Mr. SOUK. There has been a defense that has been recognized by some courts recently, called a Government contractor defense or, alternatively, a Government specifications defense that contractors have been able to use in some situations.

Some courts have been liberal in applying this defense; many others have not. There has been a string of decisions over the last 2 years in which great limitations were placed on the defense.

It is only applicable in certain situations, even when it is applied liberally. Thus, the contractors' view on this subject is that, while they welcome the development of this defense by the courts, they do not feel that it adequately solves all of the problems of liability which we have been talking about here today.

We would encourage this committee to go on with the efforts to solve the liability problems, while not trying to wait to see if this defense develops ultimately into something better than what it is now. The possibilities are very good that it will never develop into anything that would be a comprehensive solution to the problem we are dealing with here.

Senator GRASSLEY. Do you have any statistics or any evidence that we could look at of the use of that defense? If you do not have it now, if you could just supply it?

Mr. SOUK. I would be happy to supply, Senator Grassley, copies of the various decisions that have been made by courts. They are not bulky. I would also be glad to supply a brief summary statement of what it all means, if you would like.

Senator GRASSLEY. Yes; please do that.

[Aforementioned material follows:]

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June 25, 1985

Honorable Charles E. Grassley
United States Senate
Washington, D.C. 20515

Dear Senator Grassley:

This letter responds to your request at the Judiciary Committee hearing on June 11 for further information regarding recent court decisions which have recognized or rejected a government contract defense.

A government contract defense, or a "government specifications defense" as it is sometimes called, has been recognized and applied by a number of courts in recent years. These courts have generally held that three conditions must be met before a government contractor can make use of the defense: (1) the government must have established, or approved, reasonably precise specifications for the allegedly defective aspect of the product which caused harm; (2) the contractor must have complied with the specifications; and (3) the contractor must have warned the government about any hazards relating to the alleged defective aspect of the product which were known to the contractor but not to the government. The following is a list of cases in which the defense has been recognized based on the foregoing conditions:

(1) Tillett v. J.I. Case Co., 756 F.2d 591 (7th Cir. 1985);

(2) Koutsoubos v. Boeing Vertol, Division of Boeing Co., 755 F.2d 352 (3d Cir. 1985);

(3) Bynum v. General Motors Corp., 599 F. Supp. 155 (N.D. Miss. 1984);

(4) Hubbs v. United Technologies, 574 F. Supp. 96 (E.D. Pa. 1983);

(5) McKay v. Rockwell International Corp., 704 F.2d 444 (9th Cir. 1983), cert. denied, ___ U.S. ___, 104 S.Ct. 711 (1984);

(6) McLaughlin v. Sikorsky Aircraft, 148 C.A.3d 203 (1983);

(7) In re "Agent Orange" Product Liability Litigation, 534 F. Supp. 1046 (E.D.N.Y. 1982);

(8) Brown v. Caterpillar Tractor Co., 696 F.2d 246 (3d Cir. 1982);

(9) Tefft v. A.C. & S., No. C80-924M (W.D. Wash., Sept. 15, 1982);

(10) Sanner v. Ford Motor Co., 144 N.J. Super. 1, 364 A.2d 43 (1976); aff'd, 381 A.2d 805 (1977); and

(11) Hunt v. Blasius, 55 Ill. App.3d 14, 370 N.E.2d 617 (1977).

A number of courts, however, have rejected the government contract defense, as reflected in the following decisions:

(1) Nobriga v. Raybestos Manhattan Inc., 683 P.2d 389 (Haw. 1984);

(2) Hansen v. Johns-Manville Products Corp., 734 F.2d 1036 (5th Cir. 1984);

(3) Challoner v. Day & Zimmermann, Inc., 512 F.2d 77 (5th Cir. 1975), vacated on other grounds, 423 U.S. 3 (1975); and

(4) Foster v. Day & Zimmermann, Inc., 502 F.2d 867 (8th Cir. 1974).

Other courts have recognized the government contract defense but have applied stricter conditions for its use than the conditions listed above. For example, some courts have refused to apply the defense if the government approved of the specifications but did not write them. See Shaw v. Grumman Aerospace Corp., 593 F. Supp. 1066 (S.D. Fla. 1984); In re Air Crash Disaster at Mannheim, Germany on September 11, 1982, 586 F. Supp. 711 (E.D. Pa. 1984). One court would apply the defense only in cases involving weapons supplied during wartime. See Jenkins v. Whittaker Corp., 551 F. Supp. 110 (D. Haw. 1982). Another court has held that the defense would not be applicable if the products supplied to the government pursuant to government specifications are also sold commercially by the contractor. See Chapin v. Johns-Manville Corp., No. S79-0272(N)(S.D. Miss., Nov. 2, 1981).

Even if the government contract defense were recognized by all courts, the defense would not be a complete solution to the unfairness created by the Stencel case. In cases where the government did not establish specifications for the product which harmed the government employee, but the government's negligence (e.g., through faulty maintenance or misuse of the product) contributed to causing the harm, the defense would not be available and the contractor would still be left to bear all liability.

Thus, despite the existence of a government contract defense, there remains a strong need for legislation to resolve the unfairness brought about by the Stencel case.

Sincerely yours,

Fred S. Souk

Fred S. Souk

Mr. BROWN. I would add from my standpoint, I think there may be two major shortcomings to the Government contractor defense. One, it appears to have been limited to specification-type cases. It would not cover, or it apparently at this point does not cover, Government misuse or improper maintenance-type cases, which was actually the *Lockheed* case that arose where there was faulty Air Force maintenance of a plane that Lockheed had delivered some 4 years prior to the liability occurrence, Senator.

I also think it is weak from perhaps a political standpoint, since the Government contractor defense, in effect, negates recovery by the plaintiff. It throws the plaintiff out of court, and therefore deprives him of a remedy.

Senator GRASSLEY. Could the problem that we are addressing today be handled more appropriately in conjunction with pending efforts to pass a Federal products liability law?

Mr. SOUK. Contractors certainly think that the efforts to pass a Federal product liability law are good efforts and should go forward as quickly as possible. However, the legislation that is being considered on that subject is general legislation dealing with tort law problems in general.

They do not address specifically the problems that we are addressing in this legislation concerning Government contractors and the Government contracting system. Therefore, it is our strong view that it would be well for this committee to keep with its efforts on Government contractors and allow the reform of product liability law, which is very much needed, to go forward on its own.

Senator GRASSLEY. In a sense, then, are you saying that the product liability law would not apply to Government contractors, or it would not apply in enough instances?

Mr. SOUK. It would apply to Government contractors just like it would apply to anyone else in the United States in a tort suit. But what it does not do is it does not resolve the problems of massive liability that contractors now face due to the nature of Government projects, and it would not resolve the unfairness of the allocation of liability that presently exists.

It would make some progress in this regard, but it is not specifically addressed at the Government contracting situation, which is unique, and therefore it would not make a total solution of either problem we are addressing here.

Mr. BROWN. The real thrust of the product liability law is to try to overcome the great diversity of law that applies in the various States, in an effort to get uniformity, and I think that is the principal objective of that legislation, which many of us support. But it would apply across the board to commercial businesses as well as Government businesses, and I think we really have an additional and perhaps a related, but not identical issue to face.

Senator GRASSLEY. The Justice Department has raised the point that this indemnification scheme will create a deep pocket with the Government. Justice asserts that making the Government the deep pocket could even result in increasing the size of judgments because of the Government's seemingly unlimited resources.

Could you respond to that concern, and especially as it relates to section 5 of this legislation?

Mr. SOUK. To put it as simply as I can, I think that the Justice Department is wrong. The fear of the deep pocket, I think, is misplaced. This bill does not propose to create the Government as a deep pocket. It simply proposes to make the Government an indemnifier above the level of insurance reasonably available to contractors.

That level in most instances is a fairly sizable level, as Mr. Perino has stated. Even in the shrinking market of today, $150 million is generally available for large companies for product liability, and more as to certain aviation risks.

The Government would never have to pay out anything unless the effect of a disaster were to go above those levels. The people that sue the contractor are going to have to win their cases whether the Government be an indemnifier or not.

I do not think future plaintiffs are going to have any more of an incentive to try and win a difficult product liability case and sue more just because ultimately the Government may have to pay out something in the long run. So I think the Government is wrong about that and I respectfully urge this committee to consider that this bill will not disrupt what I think would be a fair system if the Government were to indemnify far more than it does today.

We need that indemnification. It is not going to provide an incentive for any more suits than there are. It is just to handle the ones that will take place if there is a disaster.

Senator GRASSLEY. Would you think that judges and juries, in your opinion, would make larger awards for the knowledge that the Government might pay?

Mr. SOUK. I personally do not think so. Unless the Government involves itself in the case, they are not even going to know about the Government being the indemnifier anyway. If the Government chooses to involve itself in the case, they are going to know that the Government is there.

The principles of how the awards are made in a tort suit are fixed principles. The jury is not allowed to go absolutely crazy, although it sometimes appears they do. There are ways to rectify that. So just because the Government is a party does not mean that the judge or the jury can necessarily award more.

I might point out that the Government is a party in many suits today and the Government is not being bankrupted just because it is called upon to meet its legal obligations when it causes harm.

I do not think there would be the effect that the Justice Department is trying to promote. I think if there were any tendency in that direction, it could be curbed by either encouraging judges and juries in this legislation or in the legislative history of this legislation not to let that be a factor.

Senator GRASSLEY. Let me have you respond, then, to another issue the Justice Department brought up about the costs associated with the Government defending its actions. They said that that could be very great, and obviously those are picked up by the taxpayers.

Can you respond to that concern?

Mr. SOUK. Well, my thought on that is that Justice has a rather extensive system of attorneys and they seem to have handled the

growth in Federal Tort Claims Act practice within reasonable bounds.

I think the mere reference to catastrophe means an exceptional situation, one that is not going to be arising every month or every year, maybe even every 5 years. So my own view is that that should be able to be accommodated within the remedial purposes that are being sought.

Mr. BROWN. One reaction I had to the deep pocket aspect is that I doubt that trial attorneys today distinguish between deep pockets. They view any defendant, whether it be a small business, large business, or the Government, as the deep pocket, and they are going to go after as much as they can in the way of damages so long as they have a theory on which to press.

Senator GRASSLEY. I would like to ask you if you think it is a valid concern on an issue brought up by the Defense Department at the time they testified. DOD is concerned that the blanket indemnification may reduce the contractor's incentive to assume responsibility for the safe performance of their products; in other words, quality control.

To the extent to which we take away this responsibility against the contract, are we going to get less quality control?

Mr. BROWN. I think there are a couple of answers to that. I think if a contractor was careless, they would face the exclusion under the statute for gross negligence and willful bad faith. So there would be a possible exclusion of the Government indemnification obligation if the contractor was completely careless.

But I think there is no basis in history to assume that contractors are going to act in an unsafe manner by looking at the many other indemnification bills that have been enacted by Congress, and also the fact that for many years there was a contract clause in many Government cost reimbursement contracts which provided for indemnification. There is no history to suggest that that induced contractors to disregard safety in their performance.

Senator GRASSLEY. You know that I asked opponents of the legislation to provide any data or documentation to support their theory that the current indemnification mechanisms are sufficiently utilized.

I would also ask you to provide any documentation that supports your assertion that the rate of Government indemnification is not sufficiently used now. Can you support that with hard data, and perhaps cases even beyond the *Stencel* case?

Mr. BROWN. Well, we have often thought that that would be obviously be very desirable information. It is very difficult to come up with, Senator. In most cases, contractors, I think, would look at a particular contract situation in an agency and decide whether they wished to bid or propose on that contract.

There may be any number of factors that may justify their decision to try to win that contract or not win that contract. If they chose not to bid or not to propose, that is not likely to be made a matter of public record. You simply would have less competition for that particular contract.

We really have no way of tracking the reasons why contractors choose not to compete for particular contract programs or contract projects. My own feeling is you will get attorneys that are interest-

ed in this subject and others interested in this subject who will know of particular situations.

At TRW, I know that this all came out—our interest in this all came out when we were refused indemnification for some of our air traffic control software, and I know that that was a factor back in the mid-1970's in our declining to get involved in that business.

But we do not have a survey and I do not know of hard data. I guess one would have to go on the fact that contractors are jumping up and down and stressing that this is an issue of concern. I also would ride a little bit on Mr. Willard's acknowledgment that this is a legitimate concern.

Senator GRASSLEY. The Government witnesses today testified that the Government lacks adequate resources to make the complex decisions involved in determining risk and potential liability. They go on to say that this is something that can be handled better with the free market system.

Now, I am one that has great faith in the free market system and I want that system to prevail when possible. So I would like to have you respond to two questions along those lines.

First, how much risk determination would the agencies be responsible for under the provisions of this bill? And, second, is there a way to leave more of those determinations with the commercial market, yet still achieve an equitable system of addressing Government fault?

Mr. SOUK. I would be glad to try and tackle those, if I might. First of all, it is important to recognize that the Senate bill as well as the House bill do depend on the free market system. They do not in any way intend to or do they in effect abrogate the free market system for ensuring against risk. Indeed, they may even encourage it because indemnification is not provided for anything that is reasonably available in the private insurance market. It is only provided where insurance is not reasonably available.

Now, under the Senate bill, there will be a need for agencies to make some determinations as to whether or not a risk is such that it could result ultimately in a liability that exceeds insurance.

That kind of a determination is not something that is foreign to the agencies; it has been done on a number of occasions. It is done by the Department of Defense now, basically, when they give indemnification. It has been done by NASA in giving some indemnification a couple of years ago. It was done by the FAA a couple of years ago in giving indemnification.

They have people in their departments who know how to look at the insurance markets and determine as best can be determined at any one time what is available and how much should be expected of contractors in getting their own insurance from the free market.

In this regard, it can be said that perhaps the House bill might be a better mechanism for ensuring that the maximum use is made of the free market because there is not a requirement up front that agencies make this determination; it is only made later on when indemnification may be requested after a disaster.

So the House bill perhaps would be a better mechanism to ensure free market use and to prevent any problems that may arise in the agencies making these determinations.

Senator GRASSLEY. OK, I have finished my questioning. Is there any thought that any of the four of you had on any of the questions, because a few of you did not speak, which I said was all right? Any last thoughts before I dismiss the panel?

[No response.]

Senator GRASSLEY. Thank you all very much for coming.

We will now immediately go to the next panel. This is our last panel: Karen Williams, chairman of the Legislative Liaison Committee, public contract law section of the American Bar Association. Joining Ms. Williams, is O.S. Hiestand, Jr., past chairman of this section and current vice chairman of the Committee on Insurance and Indemnification. I want to thank both of you for coming to give the ABA's view on this legislation.

And Mr. Robert Gusman is chairman of the Aerospace Industry Association's Indemnification——

Mr. GUSMAN. Project.

Senator GRASSLEY. The task force, right?

Mr. GUSMAN. Yes, sir.

Senator GRASSLEY. Mr. Gusman represents the Nation's major manufacturers of aircraft engines, helicopters, spacecraft missiles, space launch vehicles, and related components and equipment.

I would like to have you proceed in the way in which I introduced you. Ms. Williams.

STATEMENT OF KAREN HASTIE WILLIAMS, CHAIRMAN, LEGISLATIVE LIAISON COMMITTEE, SECTION OF PUBLIC CONTRACT LAW, AMERICAN BAR ASSOCIATION, ACCOMPANIED BY O.S. HIESTAND, JR., VICE CHAIRMAN, COMMITTEE ON INSURANCE AND INDEMNIFICATION

Ms. WILLIAMS. Thank you, Mr. Chairman. It is a pleasure for me to be here this morning to testify before the committee on behalf of the American Bar Association. With me is Mr. Hiestand, who is a past chairman of our section and currently counsel to the Committee on Insurance and Indemnification. I appear here today at the request of John Shepherd, who is president of the American Bar Association, to express our views on this most important issue of indemnification of Government contractors.

We commend you and the full committee for holding hearings on this subject and look forward to working with you on successful enactment of this legislation.

At the annual meeting of the ABA in 1983, the house of delegates voted to support Federal legislation which would alleviate the unique problem of Government contractors facing extraordinary liability as a result of their Government contract work.

You have heard this morning from numerous witnesses about the problems that exist today for Government contractors and the need for a new approach to liability protection legislation. This stems principally from the fact that existing statutory authorities have not worked very well.

In my prepared statement, I provide the committee with an analysis of the reasons that problems have existed under current authorities. The overall result of the current legislation is that where use of existing authority is deemed appropriate, agencies vary in

their reactions. Their reactions are problematical, inconsistent, and for the most part, unpredictable.

I would suggest to you, Mr. Chairman, that the approach that should be taken is one that looks at the current situation with respect to Government contractors and provides for a fair allocation of the risk involved in these unusual circumstances.

I would suggest to the committee that it is not only in the defense area, but also in the environmental area, for example, hazardous waste disposal and asbestos cleanup, that Government contractors are facing enormous liability problems.

Your colleagues on the Public Works and Environmental Committee have looked closely at this issue and are now considering a limited indemnification procedure for response action contractors, which I think is consistent with the thrust of the work that this committee has developed.

Your bill proposes one possible approach to dealing with the current problems. The operative provisions, as have been discussed earlier, are section 5 of the bill. We commend you for the advances that this bill represents. We specifically note that these are good changes and that they are substantial improvements over existing law.

The ABA believes, however, that additional corrections should be made. We think that it would be useful and we urge the committee to look at provisions in the House version of the bill. As discussed by Mr. Kindness this morning, the House bill would make most of the important factual decisions necessary to a determination as to whether a contractor should be indemnified become questions decided after the occurrence of the event rather than at the time of contracting.

In our view, such a law would establish in advance the criteria that a contractor would be required to meet in order to establish its right to indemnification. This approach would do away with the guesswork and the vagueness of the current system and replace it with a workable and fair policy that responds to the marketplace.

As you indicated before, Mr. Chairman, it is important that we let the marketplace work and that we let reasonably available insurance be the outside parameter for contractor indemnification.

I am going to ask Mr. Hiestand to address the question of the impact of an indemnification approach on the Government because I think there may have been some misstatements in the testimony from the Justice Department that we would like to clarify.

Senator GRASSLEY. Would you proceed?

STATEMENT OF O.S. HIESTAND, JR.

Mr. HIESTAND. Thank you, Mr. Chairman. I have been in this Government contract business now for some 38 years, 26 of it as an attorney for the Government, and since then engaged in the many studies and reviews of the American Bar Association, as well as my tenure as general counsel of the Commission on Government Procurement, and to some extent representing clients.

I would just like to make some real quick comments based on my experience about some of Mr. Willard's statements. On page 6 he says the Government simply is not equipped to evaluate insurance

needs in every contract. I would agree with that statement, based upon all my experience.

But as the other witnesses have said, trying to do an up-front analysis before you agree to indemnify really is what complicates that problem. How do you decide what is ultrahazardous and how much insurance is available? How many ways are you going to divide the industry in different categories?

This is why I believe the American Bar Association approach resolves that problem and does not make it necessary for the Government to try to become experts in insurance.

On page 7 his statement says indemnification removes the safety incentive created by the tort system and that neither contractors nor insurers will have a financial interest. Well, I think that is totally wrong. I can say, going back from all of my work with the Atomic Energy Commission, we used the War Powers Act to indemnify; we used the Price-Anderson Act to indemnify.

I have been involved with many contracts where 85–804 has been there, and I do not believe that the record shows that there is any reduction in the safety incentive. And in any event, under what your bill and the ABA position is supporting, the insurers and the contractors still have an incentive because the indemnification does not come in until above what the insurance amount is.

Well, that means the insurance company has still got its money at risk, and it is still going to be in there doing quality inspections and safety and all those things in the plant.

Basically, we are not talking about what happens in a contractor's facility. We are talking about what happens to the product after it is delivered to the Government.

Then it says on the same page, 7, indemnification would necessitate increased Government supervision of contractor facilities. Again, my experience would say that is not so. Indemnification is not—I have seen it now for 38 years and we did the same thing when I was in the Government where we had indemnification as where we did not.

It says it would, on the same page, inevitably increase the role of the Government in the insurance industry as the Government decides what are reasonable levels of insurance. I think that is true if you make the up-front decision on how much insurance is required before you pass the indemnification.

And it is a complex subject. There are some departments that have adequate people to do it, but we are talking governmentwide on this, so that means you would have to spread a great big new bureaucracy throughout the Federal Government to provide this capability in every Federal agency.

And the last point I would like to make is with reference to the statement on page 8. They are talking about Johns-Manville and alleging that the Government is liable for 43 percent and how much this could result in liability to the Government.

I think the statement ignores the fact that there is insurance in that situation, and under the kind of legislation we are talking about, it would still only bring in Government indemnification above whatever was the reasonable amount of insurance.

So it is not an accurate statement to just portray 43 percent of the potential liability there as saying what the Government would have to pick up.

Thank you, sir.

Senator GRASSLEY. Did you finish?

Ms. WILLIAMS. I just wanted to make one comment, Senator. As you indicated, our full text will be entered into the record. I would simply add that last February, the American Bar Association wrote you a detailed letter on this subject, providing some examples, and that may be informative to the committee as it proceeds with its deliberation.

As we perceive it, the intent of the Senate approach is to establish a statutory policy to reasonably and fairly allocate the risks, as measured by the costs of a contractor's liability to third parties which arise out of Government contract work.

The problem is how this can be done in a way that conserves the public dollars and still provides a practical and workable mechanism for achievement of a fair and equitable result, we need to assure that the best contractors perform in a reasonable and in a sound and quality manner for the Federal Government.

The ABA believes that the approach that we urge does this in a way which protects the interests of the public as well as the contractor. We stand ready to work with the committee in its work on this matter. Thank you.

[The prepared statement follows:]

STATEMENT OF

KAREN HASTIE WILLIAMS

CHAIRMAN

LEGISLATIVE LIAISON COMMITTEE

SECTION OF PUBLIC CONTRACT LAW

My name is Karen Hastie Williams. I am Chairman of the Legislative Liaison Committee of the Public Contract Law Section of the American Bar Association (ABA). With me is O. S. Hiestand, Jr., Past Chairman of our Section and current Vice-Chairman of our Committee on Insurance and Indemnification.

We appear before you today at the request of John C. Shepherd, President of the ABA, to express the ABA's views on the indemnification of Government contractors by the Government. We commend you and your Committee for holding hearings on this subject and on S.1254 the Contractor Liability and Indemnification Act.

At our 1983 Annual Meeting, the House of Delegates of the American Bar Association voted to continue the Associations' opposition to Federal preemption of state product liability law but to support Federal legislation which would alleviate the unique problem of Government contractors facing extraordinary liability as a result of their Government contract work.1/ The House of Delegates action was taken after lengthy consideration and debate, including a special study by an expert group of lawyers selected for this

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1/ Summary of Action of the ABA House of Delegates, August 1983, Report No. 113 Parts I and III.

purpose by the President of the ABA.[1] Our comments today will only focus on the contractor protection provisions.

As all of the research, studies and commentaries for the last twenty-five years have recognized, the need for new liability protection legislation stems principally from the fact that the current statutory authorities[2] (other than the Price-Anderson Act), and the Executive Orders and Regulations which implement them, have not worked very well. There are many reasons for this. Among the most serious problems are the following:

- The criteria for using the authority are vague and difficult to apply. For example, there is no legal or policy consensus on what constitutes an "unusually hazardous" risk. There has been, therefore, a marked reluctance on the part of the procuring agencies to apply this criterion, and there has been inconsistent application when it has been applied.

- The decision to indemnify is discretionary. No reasons are required to be given to a

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1/ Report No. 113 of the American Bar Association Special Committee to Study Product Liability, Report to the House of Delegates, February 1983.

2/ 50 U.S.C. §§ 1431-1435 (Public Law 85-804), 10 U.S.C. § 2354.

contractor or subcontractor whose request for an indemnification agreement is denied.

° Implementation of a decision to use the authority involves the handling of matters which are not well understood at the actual working level of those charged with such implementation. This is to say, without criticism, that Government contracting officers and contracts specialists helping them are not well versed in the concepts of indemnification, third-party liability, casualty insurance and the business practices of the insurance industry.

° Implementation of a decision to use the authority requires the parties to deal specifically with and reach agreement on matters and circumstances that are but dimly perceived (if at all) or are highly conjectural or downright speculative. These include identification and description of risk, estimates of future costs and availability of insurance, future economic and legal developments, and the utility and

useful life of a product not yet and never before built.

- The party seeking indemnification may be a subcontractor unable to deal directly with the Government except through a higher tier contractor who may or may not be an effective surrogate, advocate or representative.

The overall result of such difficulties is that, even where the use of existing indemnification authority would be clearly appropriate, reactions occur which are problematical, inconsistent, and unpredictable.

Even when the use of indemnification the authority is approved, the indemnification agreement is usually deficient. It is probable that the agreed to insurance requirements will, over time, either prove to be unmaintainable or -- as happened over the decade of the seventies -- become inadequate due to inflation. The insurance industry may reassess the risk and significantly reduce the scope of coverage or raise the cost of coverage, or deny it completely. One must also consider the possibility that the risk or coverage for the risk giving rise to liability may not be recognized as such at the time of contracting (e.g., loading fertilizer onto ships which caused the Texas City disaster in 1947; the manufacture of Agent Orange herbicide for the Vietnam war). Add to all this the previously described problem of

providing coverage to subcontractors, who are not in privity with the Government, and it is obvious that new, self-executing legislation is sorely needed.

To summarize briefly, under existing authority,[1] industry (contractors) and buying agencies (Government) must wrestle with a most complex subject matter within the context of vague terms (e.g., "unusually hazardous risk") as well as a remarkably long list of uncertainties and unknowables, and do all this on a before-the-fact, guesstimate and attempt-to-predict-the-future basis. This discouraging litany is compounded by the realization that existing authority is interpreted and implemented differently by different agencies -- even though they may be dealing with the same subject matter. A new and workable approach to this problem is required.

The Senate bill, S.1254, proposes one possible alternative for a new approach. The operative indemnification language in Section 5 on which we will focus these comments is the same as Section 5 in last year's bill, S.1839. As it currently reads, the key provisions would make the following changes to existing authority:

1. Indemnification of risks beyond reasonably available insurance would be clearly and

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[1] E.g., Public Law 85-804, 10 U.S.C. § 2354.

statutorily approved. This is now being done occasionally by some agencies on an interpretational basis.

2. A contractor would have a right to judicial review (albeit on a very narrow substantial evidence basis) of a refusal to provide indemnification.

3. Questions as to the source of funds required to make indemnificaiton payments would be clarified.

4. Indemnification policy would be established on a Government-wide basis rather than limited to national defense concerns.

The bill would not apply to purchases of "commercial products" or to liability arising out of willful misconduct or bad faith. We support these exclusions from government indemnification.

These changes are all good. They represent substantial improvements in the law. But, additional corrections are needed. Enactment of the Senate bill, would not eliminate those problems discussed above which are inherent in any approach requiring before-the-fact contractual specification of all important

indemnification measurements.[1/] Moreover, we are concerned that even with the enactment of a Senate bill, agencies that are disinclined to indemnify (even though the intent and criteria of authority can be fulfilled) will still resist this protection. Moreover, on appellate review of an agency refusal, the Court of Appeals for the Federal Circuit could be expected rarely, if ever, to reverse the agency decision despite the equities in favor of the appellant. Further, current difficulties in handling subcontractor indemnification would not be alleviated. In short even with adoption of the Senate bill, most of the problems encountered under existing authority are likely to continue. Hence, we believe, the proposed Senate approach just doesn't solve the problem.

We urge the revision of S.1254 so that most of the important factual decisions necessary to a determination as to whether a contractor should be indemnified would become questions which are decided after the occurrence of an event rather than at the time of contracting. Such a law would establish in advance the criteria that a contractor would be required to meet in order to establish its right to indemnification. This approach would do away with the guesswork and vagueness of the current system and replace it with a workable and fair policy.

1/ E.g., identification and definition of risks, determination of insurance maintenance requirements, procedures and criteria for subcontractor indemnification, etc.

The elimination of red-tape would reduce the burden of administration. Moreover, the self-executory approach would provide indemnification of subcontractors, accommodate the practices of the insurance industry, and lower the costs of contract placement and administration, thus enhancing effective competition for Government work.

To carry out this approach, we recommend that the language of the Senate bill be revised to make liability beyond available insurance (or such lesser amount of insurance as the parties may expressly agree to in advance) the sole criteria for determining which risks are to indemnified since meeting such a criteria is ultimately a question of fact which will vary with time and circumstances. It makes good sense to enact a policy which will accommodate the variables in the marketplace.

Within this approach, a contractor would be indemnified if it could demonstrate that it had made a diligent, good faith effort to secure as much insurance as was reasonably available to the company. If a contractor secured less coverage than the amount reasonably available to it, that decision would be its affair and the shortfall in coverage would be its own risk to bear. The contractor could only expect to be indemnified for claims and losses beyond the amount of insurance which was reasonably available to it. Under this approach a contractor would be motivated to secure as much insurance as subsequently became reasonably available even if, at the time of contracting, none were available. In

situations where a contractor believed that the maximum insurance would be unreasonable or inappropriate, a contractor and the agency would be authorized to reach an advance contractual agreement as to such lesser amount of insurance which the contractor would be expected to maintain. A further benefit would be the elimination of the liability issue in the source selection process -- thereby further enhancing competition for Government contract work to the ultimate benefit of the taxpayer.

As mentioned earlier, this approach would also overcome the difficulties confronted by subcontractors in situations where the prime contractor either failed to seek indemnification or, for any reason, was less than diligent in securing indemnification coverage for its subs.

Another very practical benefit of the self-executory approach is that a contractor need not incur (and presumably pass on to the Government) the expense of buying or increasing its insurance until the risks unique to the Government contract become real. On programs with a long lead time, the actual risk may not be confronted until production begins, a number of years after contract award. As a result, the costs of unneeded insurance could be saved. This approach also readily accommodates unforeseen and unpredictable developments which are important to effective indemnification such as currency inflation, deflation or devaluation, as well as changing liability laws and legal perspectives on the computation and award of damages.

As we perceive it, the intent of the Senate approach is to establish a statutory policy to reasonably and fairly allocate the risks, as measured by the costs of a contractor's liability to third parties, which arise out of Government contract work. The problem is how to do this in a way that conserves the public fisc and still provides a practical and workable mechanism for achieving a fair and equitable result. The ABA believes that the approach we urge does this in a way which protects the interests of the public as well as the contractor.

By establishing a workable and fair indemnification policy the public interest of more competition will be served, since reputable businesses can seek government contracts without legitimate concerns about bankruptcy. In addition, the public would be better assured that risks would be fairly allocated and death or injury compensated.

Some opponents have suggested that the enactment of a workable indemnification policy would cost the taxpayers too much. This is hard for us to understand since the costs of a catastrophe must be borne generally by the taxpayers in any event. A policy to allocate the risks and any resulting costs only makes good sense. The prospect that a Government-sponsored activity might result in the death or injury to victims who would be compensated only by the contractor while permitting the Government, which would have

initiated, sponsored and controlled the activity, to avoid any financial responsibility is, we believe, socially, politically, and morally untenable.

Mr. Chairman, a revision of S.1254, incorporating the ABA-recommended approach, is being prepared by our Section. We request that the Record remain open for submission of the statutory changes for the consideration of the Committee. We would be happy to work with you and your staff on revision of the language of S.1254 to accomplish our mutual objective of fair treatment of government contractors. We will be pleased to answer any questions you or members of the Committee may have.

Senator GRASSLEY. Mr. Gusman.

STATEMENT OF ROBERT C. GUSMAN, CHAIRMAN, INDEMNIFICATION PROJECT GROUP, AEROSPACE INDUSTRIES ASSOCIATION

Mr. GUSMAN. Thank you very much, Senator. The Aerospace Industry Association appreciates appearing before you today on this important subject. We appreciate your acceptance of our statement in the record.

I should also add in terms of my own background that I am also corporate counsel for Lockheed Corp., in addition to my chairmanship of the Indemnification Project Group.

I am going to depart from our prepared statement and speak to several points that have been discussed in the hearing so far. First, we believe this is a fair bill. It is fair because the Govermment is a participant in the contractors' programs that give rise to catastrophic risk.

The Government is the originator of these programs. The Government in many cases controls the specifications and controls the design. Under those circumstances, it would be appropriate, where there is catastrophic risk, which is our primary concern, if the Government did stand behind the contractor as an indemnitor.

Another point we would like to make is that the House bill has a certain simplicity to it. We believe that there is a consensus, and I think that consensus appeared today, that we all agree on what is a catastrophic or unusually hazardous risk. This is a risk that the contractor incurs that is in excess of reasonably available insurance.

The Senate bill would require a definition of unusually hazardous risk in the contract; the House bill would not. The House bill is a self-executing bill because it defines unusually hazardous risk as the risk in excess of reasonably available insurance. It is saying the same thing as the Senate bill, but it is simpler.

It is a better bill because one of our problems—in fact, the great problem is that Public Law 85–804 is so broad that the Department of Defense, for one, and many other agencies have trouble implementing it. And a simpler bill, a more focused bill, we think, will assist in indemnification because it relieves the administrators of making so many determinations that they are reluctant to Accomplish.

Another point we would like to make is that, in fact, these Senate and House bills are not new legislation. What they really do is focus and sharpen what is in implicit in Public Law 85-804. Public Law 85–804 is a basic grant to several Government agencies to indemnify contractors and that statute has been implemented by regulation that authorizes indemnification to contractors for unusually hazardous risk.

Either H.R. 1623 or S. 1254 build on that base, so we have here not a radical departure or, in fact, in my judgment, any departure at all from prior legislation, but a logical extension and clarification of it.

Moreover, these bills are advantageous to the public. If there is a catastrophe, they preserve the status quo. It means Government work goes on; Government work does not stop. Contractors do not become bankrupt.

Claimants under these bills have a way or a mechanism to recover damages. That is a great advantage in these bills which I think all the witnesses have recognized. Moreoever, it is an advantage to the work of Congress because Congress would not be concerned if a catastrophic risk occurs with private relief bills or congressional reference cases.

Moreover, the bills are procompetitive. Knowing that there is realistic Government indemnification available to them, it is going to encourage more firms to enter into Government business. It is going to encourage more subcontractors to enter into Government business. And if there is more competition, then hopefully there are lower prices.

We hope that we have reached the stage where we could, through additional work with the Justice Department and others, move the bill ahead. But we think that this is the time to move these bills ahead and see if they can be passed, and we think they are proper.

That concludes our remarks.

Senator GRASSLEY. I have just one or two questions. If either one of you want to respond, that is fine, but I will direct my first question to Mr. Gusman.

Have any member companies of your association, AIA, told you that they will no longer bid on Government contracts because of the fear of liability suits? If so, could you provide the committee with a list of those instances?

Mr. GUSMAN. We will poll the members and see. There may be one or two instances. My own perception is that we are captive companies and many of our managements feel that we cannot walk away from important Government programs. We have that as a responsibility.

There is a practical side to it, too. We have thousands and thousands of employees. In a way, we are trapped, and that is one of the reasons we feel so strongly about the need for legislation.

On important programs, there is a responsibility to go ahead. There is a responsibility to the employees to keep their jobs in being. On the other hand, legislation is so important to us because the companies are exposed, and I think that is the problem many companies find themselves in today; we are in a vise. But we will see if we can supplement the record and answer the question.

Senator GRASSLEY. Yes?

Mr. HIESTAND. Senator, I would just make two observations. Part of this has been a relatively new, developing situation. I think one of the earlier witnesses mentioned that until recently there was a contract provision in cost-type contracts which, in effect, said the Government would reimburse anything over the insurance amounts that were required.

And it was only 18 months ago that the General Accounting Office ruled that was an illegal provision. The provision is still in some contracts, and I think there are many contractors, and particularly smaller companies, who are not really aware of what has happened.

In terms of interest in doing Government business and the encouragement they are getting from the small business sources, they just do not ever look at or get into this depth of consideration of what their potential liabilities might be.

Frankly, when I talk to clients now, I do counsel with them to be very careful about taking a contract with the Federal Government.

Senator GRASSLEY. Well, as a followup, then, do you know of any members not currently doing business with the Government who are not doing work because of the liability problem?

Mr. GUSMAN. We would have to look at our files, and if I can, I would like to supplement the record on that.

Senator GRASSLEY. Yes, that is perfectly proper.

Mr. GUSMAN. Thank you.

Senator GRASSLEY. In fact, the more accurate the information is, the better for us. Could that be done in 15 days?

Mr. GUSMAN. Yes, sir.

[Prepared statement and response to questions follow:]

SUMMARY OF
AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.
CONCERNING
INDEMNIFICATION OF GOVERNMENT CONTRACTORS

Certain defense, space and nuclear programs, due to dramatic and continuing scientific advances, have the potential to cause catastrophic harm. If such an event occurred, the amounts of money required to compensate the claimants would be in excess of insurance reasonably available to contractors. Indeed, the risks involved in some programs may be so great that the cost of insurance to contractors may be unreasonable.

This problem occurs in the context of a litigation explosion in which all government contractors are exposed to liability without regard to whether they are at fault. It is equitable that the government should bear certain responsibilities for catastrophic risk if that risk results from a contract it has initiated and which is performed under its control.

In dealing with catastrophic risk, a contractor cannot include a contingency in his price to cover it. Conversely, if he does so he may find that his bid is noncompetitive. If, however, he procures insurance to cover the risk, he may find that insurance is inadequate because the limits of insurance subsequently have been decreased by the underwriters or they, because of other losses, cannot respond to the contractor's liabilities. Under these circumstances, contractors believe that they are "betting their company" when they perform these contracts.

Moreover, existing legislation contained in 10 U.S.C. 2354 and P. L. 85-804 is inadequate because it is limited and vague. These uncertainties have created doubt as to the availability of indemnification and a failure by various agencies to use their authority. And, this cloud extends to subcontractors.

We believe that H. R. 1623 could be improved if: (a) the term "unusually hazardous risk" was made self-operative; and (b) the insurance requirement was subject to the contractor's certification of reasonable availability at the time the indemnity clause was included in the contract.

H. R. 1623 follows the recommendation of the 1972 Commission on Government Procurement and we urge its enactment with the above changes.

STATEMENT OF
AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.
CONCERNING
GOVERNMENT CONTRACTOR INDEMNIFICATION

Mr. Chairman and Members of the Committee:

I am Robert C. Gusman, Corporate Counsel of the Lockheed Corporation and Chairman of the Aerospace Industries Association's Indemnification Task Group. The Aerospace Industries Association of America, Inc. (AIA), represents the nation's major manufacturers of aircraft, aircraft engines, helicopters, spacecraft, missiles, space launch vehicles, and their related components and equipment. I welcome the opportunity to testify today on behalf of AIA on the subject of government indemnification against claims or losses arising from catastrophic accidents related to work performed under a government contract.

For more than a quarter of a century, the debate over indemnification for government contractors and protection of the public has been the subject of extensive study. Dramatic and continuing scientific and technological advances have raised the issue of an accident causing harm and liabilities for which potential damage amounts cannot be estimated in advance. These risks are generally associated with defense, space and nuclear programs. The enormity of a potential catastrophe in some government programs is such that sufficient insurance would not be available, or if available, its cost would be unreasonable. Therefore, contractors could be held liable for amounts which would bankrupt them, thus leaving many claimants uncompensated.

There has been a litigation explosion which has recast former legal principles into new and less flexible doctrines of strict liability for the manufacturer. Given the choice between suing the United States under the Federal Tort Claims Act or a contractor under these favorable legal rules, the claimant will file his suit against the contractor. Modern law, then, exposes all government contractors to claims for large amounts of money when performing work in programs involving catastrophic risk.

We believe there is a clear-cut need for Congress to enact catastrophic risk indemnification legislation and we believe a consensus exists among those most affected by that risk to support the passage of this type of legislation. It is equitable that the government should bear certain responsibilities for catastrophic risk if that risk results from a contract it has initiated and which is performed under its control. Statutory government

indemnification of contractors for catastrophic risk is an objective that is long overdue.

We endorse, of course, the legislative proposals in H. R. 1623 to modify the Supreme Court's holding in the Stencel case that, under the Federal Tort Claims Act, the United States was not liable to indemnify a private defendant for damages paid to a member of the Armed Forces injured in the course of military service.

Today, our primary concern lies with Section 4 of H. R. 1623, entitled "Indemnification of Contractors." While this section uses the term "unusually hazardous risk," we believe that, for the purpose of discussion, the phrase "catastrophic risk" is more appropriate. The term "catastrophic" defines major accidents resulting in claims far exceeding available insurance coverage. This lack of available coverage would be a serious problem for both the claimant and the contractor who may be found liable for injury and damage caused by such a catastrophe.

The contractor who has been asked to submit a bid to the government for work which may involve catastrophic risk confronts a series of dilemmas. On the one hand, he is barred by applicable procurement regulations from including in his bid any contingency for unforeseen risks. Indeed, if the contingency were included in his bid, the price would be so severely distorted by the resulting increases that the bid would be summarily rejected by the government.

On the other hand, the contractor could include in his bid an amount for the cost of reasonably available insurance. This could also prove unsatisfactory as it could pit the responsible contractor against those who are less accountable. In the competition for contract award, the latter would be favored due to the lower price (a result of the absence of equivalent insurance premiums); whereas, the former, in his effort to protect his firm and its shareholders against extraordinary risk, may find himself at a price, and therefore competitive, disadvantage.

Arguably, the protection that insurance affords a contractor may be misleading. Insurance, in this instance, is written on an aggregate basis for a year. A contractor, however, faces the possibility that the accident may occur in subsequent years and at that time the amount of insurance may be inadequate because of adverse losses suffered by the underwriters in preceding periods.

A related problem occurs due to the dependence of the insured upon the

solvency of insurance syndicates who, in turn, are dependent upon the return on their investments and the amounts they have paid for claims in preceding periods. If such amounts have been used for a series of prior major incidents, the underwriters' reserves could be inadequate to meet the claims arising from a catastrophic accident.

Against that backdrop, many contractors bidding on contracts involving catastrophic risk, undertake the incurrence of possible liabilities which could prove disproportionate to the value of the contract and in excess of their net worth. We call this "betting your company." These contractors are speculating that either a catastrophic risk will not occur or that they will not be bankrupted by third party claims for catastrophic loss.

These conditions are objectionable for a variety of reasons. First, the underlying government requirement for full and open competition is transgressed due to differences between those contractors who seek to maintain reasonably available insurance and those who do not. Secondly, the absence of meaningful indemnification for catastrophic risk could dampen the competitive zeal of many firms who are asked to bid on work involving this type of risk. Thirdly, it is neither fair nor appropriate for the government to force their contractors to gamble their businesses on probabilities beyond their control by bidding on programs involving catastrophic risks.

Legislation has been enacted, including the field of nuclear energy now covered by the Price-Anderson Act, to provide protection against the risk of catastrophic accidents, but it is piecemeal and inadequate in coverage. I would like to briefly review the existing statutes and indicate those cases where an adequate solution to the problem is not afforded.

The Price-Anderson Act (42 U.S.C., 2210 et seq.) is a case in point, though it offers comprehensive coverage under nuclear incidents. This Act does not cover all government programs in which nuclear energy is utilized. Similarly, another, but related statute is Section 210 of P. L. 98-212, the 1984 DOD Appropriation Act. This bill converts suits against contractors who carry out a contract in the conduct of the United States atomic testing program into a suit against the United States, but this law too, does not extend to nuclear incidents arising out of nontesting situations.

A third statute relates to military research and development indemnity (10 U.S.C. 2354). This statute is inadequate because of its limited coverage both as to type of agency (military) and type of program (R&D but not production). And, because it is not self-implementing, it must be negotiated

on a contract-by-contract basis. This has led to uncertainty as to the availability of this statutory protection and a failure by various military agencies, generally, to utilize it. We submit that protection for catastrophic risk should not be governed by such irrelevancies as the relative bargaining position of the contracting parties when they enter into a government contract under which catastrophic risk may occur.

The military departments and other agencies have turned increasingly to P. L. 85-804 (50 U.S.C. 1431-1435) as authority to provide indemnification coverage in hazardous programs. This statute is also not self-implementing, thus presenting the same problems as found under the military research and development statute regarding uncertainty and lack of uniformity in application.

It should be emphasized that the status of subcontractors at any tier is unsure under both statutes. The fate of these subcontractors appears to rest in the hands of government officials reluctant to accept responsibility for what they perceive as a proliferation of indemnity clauses. In contrast, the Price-Anderson Act automatically extends the prime contract indemnity to all subcontractors and suppliers of the Department of Energy weapons project.

P. L. 85-804, like 10 U.S.C. 2354, is also silent on the matter of required financial protection. This results in important policy questions as to required insurance being left entirely on an ad hoc basis to the contracting agency. This lack of specificity invites inconsistent treatment among the various government agencies.

The two statutes just discussed constitute the principal authority currently available to agencies with major programs in which the risk of catastrophic accidents is present. (Other statutes include: 42 U.S.C. 2746 (Swine flu vaccine) and 42 U.S.C. 2458b (Space vehicle user indemnity).)

The bold truth is that H. R. 1623 is a necessary measure worthy of your approval. We believe, however, that it would be improved if the term "unusually hazardous risk" was made self-operative and removed from the bargaining process. Unless this is done, as a practical matter, contractors will be confronted with government agencies who decline to exercise their authority. In addition, we believe it would be desirable if the requirement for insurance was subject to a contractor's certification of reasonable availability at the time the indemnity clause is included in the contract rather than subjecting this issue to unnecessary and costly executive agency procedures for each contract involved.

In 1972, the Commission on Government Procurement carefully examined the subject of and the consequences resulting from catastrophic risk which could arise under government contracts. Mr. Chairman, I would like to conclude my remarks by referring to their persuasive and authoritative recommendation that Congress should: "Enact legislation to provide government indemnification, above the limit of available insurance, of contractors for liability damage arising from a catastrophic accident occurring in connection with a government program."

Thank you for this opportunity to present the views of AIA. I would now be pleased to try to answer any questions you might have.

Aerospace Industries Association of America, Inc.

Office of the Vice President

June 28, 1985

The Honorable Charles E. Grassley
United States Senate
Washington, D. C. 20510

Dear Senator Grassley:

On June 11, 1985, during the Judiciary Committee hearing on S. 1254, "Contractor Liability and Indemnification Act", you asked, with respect to the Aerospace Industries Association, "Have any member companies of your association, AIA, told you that they will no longer bid on government contracts because of the fear of liability suits?" While we did not have that information available to us at the hearing, we agreed, with your consent, to submit our response as a supplement to the hearing record.

Now, we have obtained the necessary information from the AIA member companies who have responded to your inquiry. Incidentally, in asking our members for this information, we told them it could be supplied on a non-attribution basis. It is as follows:

1. Has any AIA member company declined to bid for or accept the award of a government contract because that company could not be indemnified by the government for catastrophic risks?

   The consequences of unusually hazardous or nuclear risks arising under government contract, generally, do influence the business decision process.

2. Has any firm declined to act as a subcontractor to an AIA member company because this type of indemnification was unavailable?

   One member has advised us that it elected not to enter into a line of business for the government because government indemnification was unavailable. Two companies informed us that as a general policy, they would decline to perform government work involving unusually hazardous or nuclear risks as a prime or subcontractor unless they were appropriately indemnified. Another contractor responded that unless the government was, "willing to accept the responsibility for the unusually hazardous risks inherent in such projects, we may be forced to seriously consider withdrawing from two projects which are of vital concern to our nation." A fifth company stated that it is currently facing a business decision where it may have to decline entering into a subcontract as the prime contractor may not be able to indemnify it because of an unusually hazardous risk involving the removal of a substantial amount of asbestos. Another firm submitted a similar reply with regard to a subcontract it had declined to accept involving an undisclosed product. Finally, a company stated that it has declined to bid on various contracts related to nuclear reactor programs.

3. Has any AIA member company or any of its subcontractors withdrawn from any line of business or determined that it would not enter into a line of business because indemnification against catastrophic risk was not available to it?

   One company has entered into a contract with the government with the condition that when it begins to perform hazardous work it will suspend contract performance until indemnification is granted.

Three AIA members expressed their concern with regard to deficiencies in the acquisition system due to the lack of clear-cut indemnification authority. Two firms commented on inconsistent indemnification policies within the procuring agencies. One of them stressed his belief that in certain competitive situations he was excluded from a contract award because he insisted upon indemnification. This contractor added that in other contracts, the government's failure to provide indemnification at the outset of a contract's performance and failure thereafter to take the necessary action to grant indemnification, although requested to do so, created situations in which subcontractors refused to deliver their end products until indemnification was provided.

While some AIA members did not respond to your questions, those answering stressed the importance of the proposed legislation to an efficient and fair procurement system.

In addition to the foregoing, we have carefully examined the Department of Justice (Civil Division) statement on S. 1254, as submitted to the Judiciary Committee on June 11th. Attached, as an aid to the work of the Committee on this legislation, are the AIA comments on the Department's statement.

Thank you for considering our views and the information AIA has submitted.

Sincerely yours,

Lloyd R. Kuhn
Vice President
Legislative Affairs

Attachment

AIA COMMENTS
ON
CIVIL DIVISION, DEPARTMENT OF JUSTICE STATEMENT
CONCERNING
GOVERNMENT CONTRACTOR INDEMNIFICATION
BEFORE THE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
ON
JUNE 11, 1985

1. Justice Department Assertion

On page 2 of its statement, the Justice Department states, "In the past few years, the efforts of government contractors to transfer their product liability exposure to the government has increased dramatically."

AIA Comment

This statement is misleading because the government's primary statutory indemnity authority is derived from a World War II statute, Title II of the First War Powers Act. This authority was made permanent in 1956 with Congress' enactment of P. L. 85-804. In addition, authority to indemnify R&D contractors for unusually hazardous risks was enacted in 1953 as 10 U.S.C. 2354. The key problem contractors face is that: (a) The standards under which indemnity may be granted are too narrow and uncertain to be effective, and (b) government administrators are reluctant to exercise their discretion to use this authority in any consistent or fair way. Since the government initiates and directs many programs involving catastrophic risk, it is a fallacy to suggest there is some inappropriate effort by contractors to transfer "their" product liability exposure to the government.

2. Justice Department Assertion

On page 6 of its statement, the Justice Department states: "Providing government indemnification will only pass tort judgements to the 'deep pocket' of the taxpayer."

AIA Comment

This is a conclusion by the Justice Department that is both argumentative and speculative. The intent of the legislation under consideration is to provide indemnity to contractors for catastrophic risk in excess of reasonably available insurance. What a court or a jury would do in assessing damages in this situation is guesswork. The court or a juror's experience would lead it to believe that, if a large contractor is a defendant, a "deep pocket" is already available to satisfy a judgement because of the existence of a major corporation's assets and the presumption that it must carry insurance. A catastrophic occurrence is likely to involve multiple contractors and the liability would be shared among them. On this basis, and since judges and jurors are taxpayers, it seems difficult for the Justice Department to sustain the proposition that government indemnification will inflate money judgements in catastrophic risk litigation.

3. Justice Department Assertion

On page 6 of its statement, the government states, "The government simply is not equipped to evaluate insurance needs in every contract."

AIA Comment

The Justice Department's concern is overstated because there is no intention or requirement that agencies ascertain or control the insurance needs of each contractor in every contract being performed. Neither does the proposed legislation require such an evaluation for every contract or even a significant percentage of government contracts as a whole. The government's concern will be in procurements where a catastrophic risk is identified. It is in an agency's interest to ascertain the financial limits of the contractor's insurance program and the amount of its premiums. This is, we believe, the current practice in DOD, NASA and in the FAA when they provide indemnity under their contracts. No extraordinary capability is required to

make this cost effective analysis when warranted under a specified contract. The insurance market determines the form and content of liability insurance policies. It is possible, however, where indemnity is provided by the government, that lower insurance costs may be incurred under its contracts. This obviously is in the interest of the government as well as contractors.

4. Justice Department Assertion

On page 7 of its statement, the Justice Department states, "Indemnification removes the safety incentive created by the tort system. To the extent liability can be passed to the government, neither the contractors nor the insurers have a financial interest in insuring that a product is designed and made with the safety of the user in mind."

AIA Comment

This is the old saw that if the contractors could contract away their liability for negligence, they will have a tendency to be more negligent. This is a misplaced argument here because many important features of government contracts are under the government's control. This control extends to a product's design, manufacturing and quality. Moreover, the proposed legislation does not affect the rights of third parties to bring suit; nor does it insulate contractors from certain acts of managerial misconduct. The contractor has an incentive to avoid negligent behavior because his insurance rates will increase and his competitive position will decrease if he does not act prudently. If a contractor's insurance premiums increase, that increase will reduce his profits because he must absorb these costs. Thus, the contractor has a real economic incentive to exercise due care in contract performance. Lastly, in a 1976 study by the U. S. Department of Commerce, it was noted that recent increases in the number of products liability claims, policy cancellations, insurance premiums, and average loss per claim have contributed to a situation in which manufacturers are finding it more and more difficult to obtain adequate coverage. The upshot is that many manufacturers are making stronger efforts to improve design and quality control. See, Bureau of Domestic Commerce, U. S. Department of Commerce, Product Liability Insurance - Assessment of Related Problems and Issues at page 9. One commentator has noted, "these developments compel the conclusion that products liability litigation is increasingly forcing manufacturers to improve product safety even when they are insured against claims for product injuries." Owen, Punitive Damages in Products Liability Litigation, 74 Mich. L.R. 1258, 1310 (1976).

Senator GRASSLEY. In fact, as acting chairman now, I can say that you might expect written comments from members who could not be here, you and other panels. We would like to have those responses back in 15 days. It gives you an opportunity, too, to correct or supplement the record.

Also, as you have been asked to do in this particular case to respond to a specific question or request, we would like to have that in 15 days as well.

Mr. HIESTAND. Mr. Chairman, there is something that is a matter of public record, and this was a bill that was enacted by Congress, I am going to say about 3 years ago to, in effect, extend the authority of Public Law 85-804 to the Department of Energy synfuel program because of the difficulty that was encountered in trying to make contracts.

The companies would go in to do that R&D development on synfuel things with the research that was coming along showing the hazardousness of waste materials from that. But it was a program that no one, neither the Government or industry, wanted to say was ultrahazardous, but the exposure was very clear.

So, eventually, the DOE asked for and the Congress passed legislation, and so there is a committee report and writeup of the neces-

sity for doing that. Otherwise, the authorities were inadequate and DOE did not think it could get contractors to go ahead and make contracts.

Senator GRASSLEY. OK. Now, for the ABA position, and that is in regard to the critics of this Government indemnification approach. They say that it would only pass tort judgments on to the deep pocket of the taxpayer. So I would like to have the response of Ms. Williams to that.

Ms. WILLIAMS. Mr. Chairman, in our view, the indemnification approach will save money. It will not cost the government the unlimited funds that have been suggested. It appears to us, based on our experience in working with Government contractors, that in the situations where you are requiring the Government contractor to carry the maximum amount of insurance available, that contractor is going to act in a responsible way. The dollars judgments that would arise out of any case would be covered by insurance up to that amount.

It would not be first-dollar coverage that the Government would be asked to bear; it would only be the cost above that, and that level of liability is not going to be achieved except in the most extraordinary circumstance.

So I think the suggestion that, with indemnification, everyone is going to go out and file suit against government contractors because they know that that indemnification provision exists just is not borne out by reality. Perhaps Mr. Hiestand would like to elaborate on that.

Mr. HIESTAND. Well, I would just make a quick comment. If you are going to think about what the jury might do, they are all taxpayers. If they knew the Government had to pay part of it, you might figure they would come in with less money to save their own pockets.

But I agree with what Ms. Williams said and Mr. Souk. I just do not think history and experience would show that that would be the kind of result the Justice Department was asserting in its statement.

Senator GRASSLEY. My last question would be to both of the witnesses.

Earlier we heard testimony that this indemnification system would remove the safety incentive that is within our tort system. To the extent to which you agree or disagree and why you agree or disagree, I would like to have your response.

Mr. GUSMAN. Could you clarify the question? Remove the safety?

Senator GRASSLEY. Yes.

Mr. GUSMAN. Within the court, within the judicial system?

Senator GRASSLEY. Yes.

Mr. GUSMAN. Or, in a sense, relieve contractors of—maybe they are less responsible under the contract?

Senator GRASSLEY. Within the tort system itself. It is probably more appropriate for Ms. Williams, but if you would respond, I would appreciate it. If you do not want to, that is OK.

Ms. WILLIAMS. I think we can both respond. I think you might simply look at the fact that the historical record of the Government contracting industry, and particularly the aerospace industry, has been exemplary. And the insurance that is available for aero-

space manufacturers is considerably higher than is generally available, and that is because of their strong safety record.

And I think that the Congress could be assured that the insurance carriers would continue to maintain rigorous review and monitoring of the work of the Government contractors, as, of course, do the agencies in terms of the quality assurance provisions which, contractually, they are required to meet.

Mr. GUSMAN. I would agree.

Mr. HIESTAND. Can I add one more thing to that? I think we said earlier that you have still got the insurance company and the contractor there with a base amount of liability which is theirs in the initial instance if they deliver a product that ends up injuring somebody.

The other thing in Government contracts is that many Government contracts have extreme and I would say severe, maybe too severe, warranties on products that are delivered. Well, the contractor has to take all of his obligations into account in looking after a quality product.

He can be hurt for liability under his warranty thing. If it is a major situation that comes up, the very fact that the contractor's name is identified with it can cause severe damage to a company, particularly one that does both government and commercial work.

So I think it is really frivolous of the Justice Department to try to make that kind of a technical assertion that merely giving indemnification means that everyone will go out and act irresponsibly and unsafely. I do not believe history or the record will support that kind of a conclusion, sir.

Senator GRASSLEY. I want to thank each of you. I am done with my questioning.

I want to submit for the record a statement before adjourning by Senator Mitch McConnell, who is a member of this committee, on this subject. That will be inserted in the record.

[The following was received for the record:]

STATEMENT OF SENATOR MITCH MCCONNELL
BEFORE THE SENATE COMMITTEE ON THE JUDICIARY
HEARING ON CONTRACTOR'S INDEMNIFICATION
JUNE 11, 1985

MR. CHAIRMAN, I'M GLAD FOR THE OPPORTUNITY TO PARTICIPATE IN THIS HEARING, ESPECIALLY IN LIGHT OF THE FACT THAT I WAS NOT A MEMBER OF THIS DISTINGUISHED BODY WHEN THE 98TH CONGRESS HELD HEARINGS ON THE VERSION OF THE BILL INTRODUCED IN THAT CONGRESS.

I COME TO THIS HEARING WITH AN OPEN MIND, FOR I HAVE NOT FOCUSED ON THIS PROBLEM TO THE EXTENT THAT SENATOR GRASSLEY HAS. THE ISSUE IS BY NO MEANS A SIMPLE ONE, FOR THE ENTIRE SUBJECT OF GOVERNMENT CONTRACTING AND FEDERAL PROCUREMENT SEEMS TO HAVE A CERTAIN QUALITY OF UNAPPROACHABILITY. WHILE THE ISSUE INVOLVED WITH THIS BILL IS SIGNIFICANTLY NARROWER THAN SOME THAT HAVE BEEN IN THE NEWS RECENTLY, THE PROBLEM IS NEVERTHELESS NOT AN EASY ONE. I AM VERY INTERESTED IN THE NEED FOR REFORM OF THE LAW AS IT NOW RELATES TO GOVERNMENT CONTRACTING AND TO TORT LIABILITY OF THE GOVERNMENT'S CONTRACTORS. THE POTENTIAL SCOPE OF THE PROBLEMS FACED BY GOVERNMENT CONTRACTORS, BECAUSE OF THE SIZE OF THE GOVERNMENT'S CONTRACTING ACTIVITY, IS TREMENDOUS. BUT, CONSEQUENTLY, SO IS THE POTENTIAL IMPACT OF THE CHANGES IN THE LAW THAT THIS BILL PROPOSES.

I CONFESS THAT I HAVE A GREAT MANY QUESTIONS ABOUT THE NEED FOR THIS LEGISLATION. IT IS DIFFICULT TO FEEL A GREAT DEAL OF SYMPATHY FOR THE GOVERNMENT CONTRACTOR IN THE ABSTRACT, ESPECIALLY IN LIGHT OF THE INFORMATION WE RATHER ROUTINELY RECEIVE NOW ABOUT ABUSES IN THE PROCUREMENT PROCESS. ON THE OTHER HAND, MANY GOVERNMENT CONTRACTORS ARE SIMPLY SMALL BUSINESSMEN TRYING TO GET THE BEST JOB DONE FOR A FAIR PRICE. STILL, CONGRESS HAS HISTORICALLY LOOKED UPON WAIVERS OF SOVERIGN IMMUNITY WITH DISFAVOR, AS HAVE THE COURTS, AND THIS BILL IN ESSENCE AMOUNTS TO SUCH A WAIVER. MOREOVER, IT IS NOT AT ALL CLEAR TO ME THAT GOVERNMENT CONTRACTORS AS A GROUP DESERVE LEGISLATION EXEMPTING THEM FROM THE PROVISIONS OF THEIR OWN STATES'

LAWS OF INDEMNITY AND CONTRIBUTION. EVEN WHERE A GOVERNMENT CONTRACTOR IS A SYMPATHETIC ONE, AS IN THE CASE OF SMALL BUSINESSMEN, WHY SHOULD HE BE ENTITLED TO INDEMNIFICATION FOR CLAIMS AGAINST HIM WHEN, BECAUSE HIS STATE'S LAW PRECLUDES INDEMNIFICATION, HIS COMPETITOR DOING NONGOVERNMENT WORK IS NOT SO ENTITLED?

AT THE SAME TIME, THE PROBLEMS FACED BY GOVERNMENT CONTRACTORS, LARGE AND SMALL, WHO DEAL WITH ESPECIALLY HAZARDOUS ACTIVITIES OR WITH GOVERNMENT SUPPLIED SPECIFICATIONS CAN BE ACUTE. IF INDEED, BECAUSE OF THE ULTRA HAZARDOUS NATURE OF THE WORK CONTRACTED FOR THE CONTRACTOR IS NOT ABLE TO ADEQUATELY INSURE AGAINST CATASTROPHIC LOSS, THEN IT SEEMS THAT PERHAPS CHANGES IN THE LAW ARE IN ORDER. THIS IS ESPECIALLY TRUE IF, AS I AM TOLD, MANY FEDERAL AGENCIES ARE PERMITTED TO INDEMNIFY CONTRACTORS, BUT ARE NOT REQUIRED TO DO SO. IT IS NOT SURPRISING THAT CONTRACTING OFFICERS ARE RELUCTANT TO DECLARE THEIR OPERATIONS ULTRA HAZARDOUS AND TO INCREASE THE COST OF THEIR PROCUREMENT ACTIVITIES. I WILL BE INTERESTED TO LEARN THE EXTENT OF THIS PROBLEM, AND OF THE IMPACT IT HAS ON EVERYONE INVOLVED.

I AM INTERESTED IN KNOWING MORE ABOUT THE SITUATION, THE EXTENT OF THE PROBLEM, AND THE POSSIBLE SOLUTIONS. I HOPE THAT THIS HEARING WILL SHED LIGHT ON THESE AND OTHER QUESTIONS, AND I LOOK FORWARD TO REVIEWING THE TESTIMONY OF THE WITNESSES.

THANK YOU, MR. CHAIRMAN.

Senator GRASSLEY. In closing, I would like to say that we have heard conflicting remarks regarding whether or not this provision will increase damage awards or substantially increase the cost to the Government.

These, of course, are issues we should attempt to resolve and I hope that we can move forward toward an agreement from all sides on this legislation.

I want to thank all of the witnesses of the various panels who appeared today to give their helpful testimony on the issue of government contractor indemnification, and specifically on S. 1254.

I am very interested in reaching a consensus that addresses both the contractor liability problem and the potential costs of passing this problem on to the taxpayers. As I have said, the record will stay open for 15 days and any interested parties that want to submit information can do that, including people who were not asked to testify.

I thank you, and this meeting is adjourned.

[Whereupon, at 11:44 a.m., the committee was adjourned.]

APPENDIX

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

ALBERT D. BOURLAND
VICE PRESIDENT
CONGRESSIONAL RELATIONS

1615 H STREET, N.W.
WASHINGTON, D.C. 20062
202/463-5600

July 17, 1985

The Honorable Charles E. Grassley, Chairman
Subcommittee on Administrative
Practice and Procedure
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of the U.S. Chamber of Commerce, I wish to offer this statement in support of S. 1254, the Contractor Liability and Indemnification Act.

The Chamber is the world's largest business federation of companies, chambers of commerce, and trade and professional associations. Many of our members provide a variety of goods and services to the federal government.

This bill provides for the equitable reduction of government contractor liability to government employees when the government is partially at fault and indemnifies contractors against third-party liability in specified situations.

Its companion bill, H.R. 1623, reflects the recommendations made by the American Bar Association (ABA) with respect to contractor indemnification. The major thrust of the ABA recommendations is to simplify the procedures for, and application of, indemnification. Further, potential controversies between the contractor and the government agency would be eliminated, unless a serious liability exposure occurs and a demand for indemnification is made.

We strongly urge revision of S. 1254 along the lines of H.R. 1623 to establish, in advance, the criteria that a contractor would be required to meet in order to establish his right to indemnification.

We respectfully request you to include our comments in the hearings record. Thank you for the opportunity to present our views.

Sincerely,

Al Bourland

Albert D. Bourland

cc: Members of the Subcommittee
Alice R. Milder, Majority Chief Counsel
Eddie O. Correio, Minority Chief Counsel

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